REINVENTING FOR GROWTH

Dear Friends:

You may have noticed a touch of Leonardo da Vinci in our report. For a year of reinventing PepsiCo for growth, he seemed a handy metaphor.

Endlessly creative and energetic, Leonardo mastered the sweet things of life, like the Mona Lisa, and the not-so-sweet, like war machines.

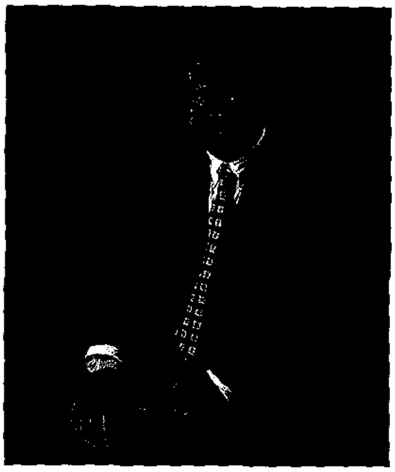
Financial Highlights

PepsiCo, Inc. and Subsidiaries

($ in millions except per share amounts; per share amounts assume dilution)	**December 27, 1997**	December 28, 1996	**Percent Change**
Summary of Operations			
Net sales	**$20,917**	20,337	**+3**
Operating profit	**$ 2,662**	2,040	**+30**
Income from continuing operations	**$ 1,491**	942	**+58**
Per Share	**$ 0.95**	0.59	**+62***
Cash Flows			
Provided by operating activities	**$ 3,419**	3,192	**+7**
Free cash flow from continuing operations	**$ 1,382**	725	**+91**
Free cash flow including discontinued operations	**$ 7,618**	1,330	**NM**
Share repurchases	**$ 2,459**	1,651	**+49**

* Based on unrounded amounts

NM – Not Meaningful



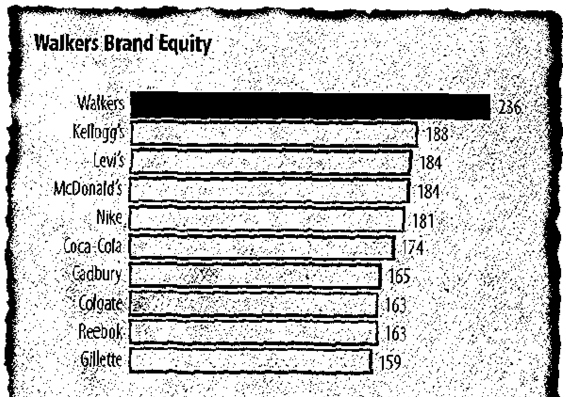
Roger A. Enrico
Chairman and Chief Executive Officer

Contents

Artist, engineer, scientist, mathematician – if he did it, he excelled.

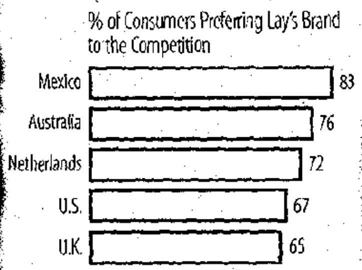
For a company like PepsiCo, emulating that kind of excellence is essential to success in the marketplace. So before I share some pretty good 1997 financial results, let me mention the two areas where I consider excellence absolutely critical to our future: *consumers* and *customers.*

First, consumers. The biggest factor in the long-term success of a consumer product company is whether more people fall in love with your products each year. If they do, the rest is simple.



Consumer Favorites. In the United Kingdom, our Walkers brand potato crisps is the best-liked and most recognized branded product. Brand equity is a composite of brand recognition and consumer regard for the brand. The higher the score the more people are aware of the brand and the more highly the brand is regarded.

But in this business, love doesn't come easy. You have to give people *exactly* what they want, when and where they want it. To us, doing that very well is more important than anything else. That's why we measure our marketplace performance as carefully as we measure our financial performance. We evaluate product



Giving Consumers What They Want. Potato chips typically serve as our entry to snack markets around the world, so we want our flagship Lay's brand to be the best. Using proprietary potato varieties, we've designed our basic chip so that consumers almost everywhere prefer our chips to the local favorite.

quality, service, value, brand image and employee performance – all in an effort to see how we're doing in the eyes of consumers and what we need to do differently. We take it *very* seriously.

So that's our first and most important goal: to make consumers happy.

The second area where excellence is absolutely critical involves our customers – the supermarkets, convenience stores, restaurants and other businesses that sell our products to consumers.

Retail and foodservice customers are as fundamental to our success as Pepsi and Doritos. We grow by making them more profitable.

To do that we're revving up our already powerful sales team. We're giving them additional tools and know-how so they can do more for our customers. It's a huge opportunity. Unlike companies that sell through distributors or wholesalers, we have our own salesforce of 63,000 people, most of whom call on customers *directly*. They're out in the marketplace, in the stores, putting our drinks and snacks on the shelves. If we can help them help our customers the benefit to PepsiCo will be enormous.

Pepsi-Cola		Frito-Lay		Total Sales Force
22,000	+	41,000	=	63,000

Worldwide Selling Power. Our huge selling team is helping retailers find new ways to build their businesses, like placing our snacks outside the traditional snack aisle, which generates big additional sales.

Reinventing to Win in the Marketplace

The point is this: Everything we did in 1997 was aimed at reinventing PepsiCo to win in the marketplace. For a consumer product company, that's all that matters.

That's what I've tried to communicate in speeches to employees, to bottlers, to security analysts. You'll recall I shared a similar message in our report a year ago. But then it was still in the idea stage, a strategy to position PepsiCo for a very bright future, and to give us the resources to get there fast. Basically it boiled down to:

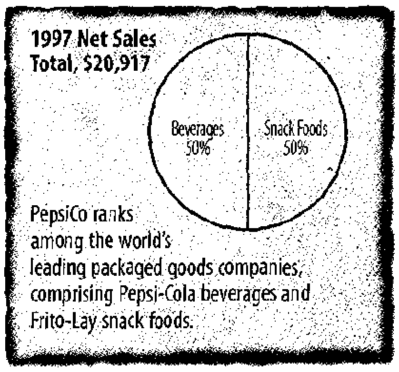
- focus on our strengths,
- manage for even stronger cash flow,
- invest aggressively in big opportunities.

Over the last year we executed that plan, setting the stage for PepsiCo to become much more powerful with customers and consumers. Let me take you through our progress, point by point.

Strategy: Focus on Our Strength

Our strength lies in two powerful packaged goods companies: Pepsi-Cola beverages and Frito-Lay snacks. They're what we do best.

Since PepsiCo's birth in 1965, we've demonstrated our ability to develop and grow these businesses profitably, year after year.



In 1997 we took a huge step to focus every ounce of our resources on our packaged goods strengths by leaving the restaurant business entirely. It wasn't easy parting

ways with great friends or great brands. But it was clear restaurants and packaged goods were very different businesses. Keeping them together limited the potential of both.

So we combined Pizza Hut, KFC and Taco Bell into a $10 billion company called Tricon Global Restaurants and spun it off to our shareholders. We sold our smaller restaurant businesses to outside investors.

At the same time, we sought greater focus *within* snacks and beverages, by restructuring certain operations for greater productivity and disposing of some businesses – all to reduce distractions and position us for growth. We also continued to rebuild our international beverage unit, placing five major bottling businesses under the new leadership of strong, well-financed partners and reestablishing our brands in Venezuela, which we refranchised in 1996.

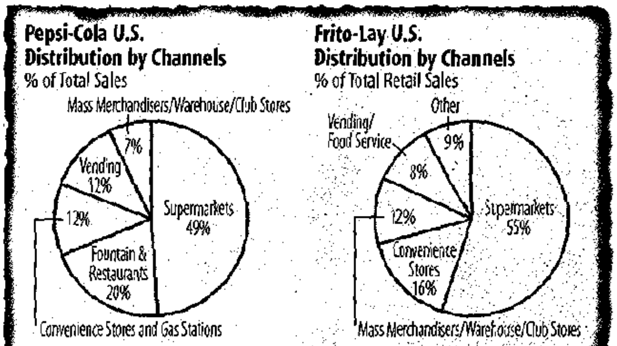
New International Beverage Partners

Location	Partner	Strength
Brazil	Brahma	Largest brewer in Latin America
Goa, India	Goa Bottling	Highly experienced local bottler
Japan	Suntory Ltd.	Second largest beverage company in Japan
Monterrey, Mexico	Pepsi-GEMEX	Mexico's biggest Pepsi-Cola bottler – expanded
Philippines	Guoco Group	Financially strong local partner
Venezuela	Empresas Polar	Biggest brewer in Venezuela

Today PepsiCo is Pepsi-Cola and Frito-Lay. We're a simpler corporation, focused on two excellent businesses with a lot in common. Both involve inexpensive consumer products with almost universal appeal. Both have large-scale manufacturing and distribution systems. Both sell through essentially the same retail

customers. And perhaps most important, both have growth opportunities that are truly vast.

We believe there are very significant opportunities to leverage the common traits of these businesses, especially in the marketplace.



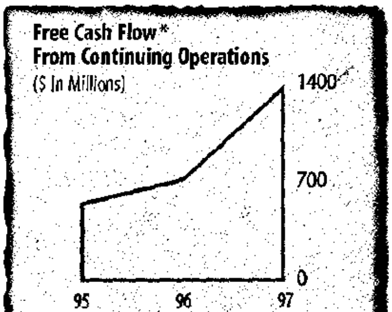
Selling Synergy. Our beverage and snack food businesses share common channels of distribution and call on virtually the same customers, especially in the supermarket and mass merchandiser channels where we have tens of thousands of customers in common.

Strategy: Manage for Greater Cash Flow

One of PepsiCo's most alluring qualities, financially speaking, has always been cash. A powerful cash flow has fueled our growth and driven our stock for 32 years. More cash fuels more success.

To increase our cash flow, in 1997 we virtually overhauled the way we manage cash. The bonuses of executives at every division were tied to achieving ambitious cash targets. We improved the accountability of managers who use capital. We created mechanisms to monitor investments more systematically.

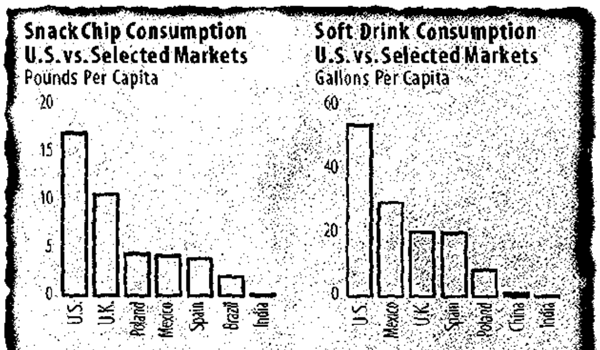
The result? Free cash flow – what's left after providing working capital to our businesses, making investments and paying taxes, dividends and interest – nearly doubled in our snack and beverage operations, to almost $1.4 billion. The restaurant spin-off and sales of other restaurant businesses produced onetime cash proceeds of $5.5 billion. And when you add in another $700 million from restaurant operations, including refranchisings, our total free cash flow for the year was more than $7.6 billion.



*Defined as net cash provided by operating activities reduced by cash dividends paid and adjusted for the following investing activities: capital spending, sales of businesses, sales of property, plant and equipment and other, net.

Strategy: Invest in Big Opportunities

The way I see it, the single greatest thing about selling snacks and beverages is the massive scale of the opportunity. If you think about it, almost every man, woman and child on Earth is a potential consumer. And, if you give people the snacks and beverages they want at a good price, there's almost no limit to how much they can consume.



Global Consumption is Low. Snack foods and soft drinks are universally popular. Low per capita consumption in many countries means lots of growth potential.

Already the global snack and beverage industries generate about $150 billion in annual retail sales. And that's growing. For PepsiCo – the world leader in snacks and strong number two in beverages – all this suggests a truly enormous growth opportunity over many, many years.

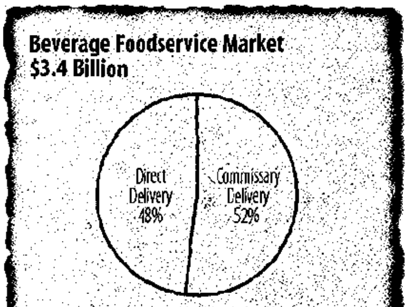
Think about it this way: If per capita soft drink consumption in India and China grew to even *half* that of Mexico, our international beverage business would more than double – and that's assuming no change in our market share.

But in these businesses it takes money to make money. Success requires investment,

Changes in Pepsi-Cola Packaging Over a Century. Since Pepsi-Cola began in 1898, our packaging has evolved to remain contemporary. The latest change, launched on our 100th birthday, is the new Pepsi Globe packaging. The blue package stands out on the supermarket shelf, is very contemporary and raises consumer awareness to an even higher level for one of the world's most popular brands.

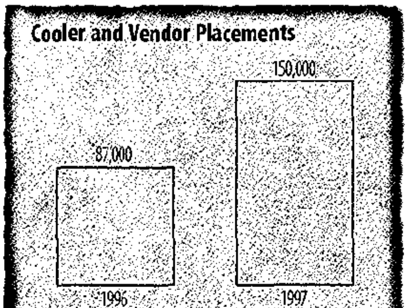
lots of it, to compete more effectively, manufacture more efficiently, distribute more widely and promote more aggressively.

So in 1997 we invested in the marketplace in a big way, a trend we plan to continue. We spent on things that *will* make more and more consumers fall in love with our products – and make PepsiCo much stronger. Let me give you some examples:



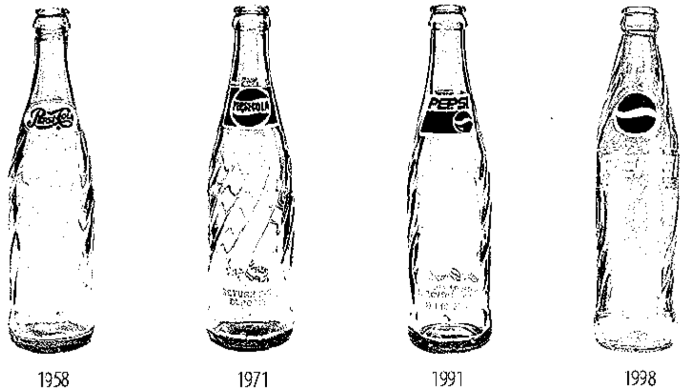
Expanding Distribution. Our beverage business is strong among foodservice accounts that accept direct delivery. But for years our bottling contracts kept us from serving most foodservice accounts that require delivery through a commissary, a centralized distributor. We've changed these contracts, and we're investing to develop this $1.8 billion opportunity.

Expanding distribution. In 1997 we installed over 150,000 beverage vending machines and coolers in North America. We'll do even more in 1998. We also formed a team to expand our fountain beverage business in restaurants and foodservice, where historically our bottling contracts made it hard to serve the thousands of accounts requiring delivery to a central commissary. Changing the contracts created a long-term growth opportunity.



We're stepping up placements of vending machines and coolers.

Marketing aggressively. To compete more effectively in the global beverage arena, we're advertising and marketing much more aggressively in key markets, especially North America. Our bright new Pepsi globe logo is just part of a major effort to build and develop our brand

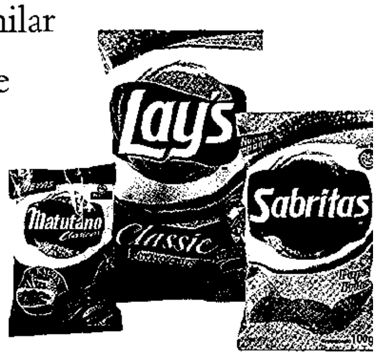


New Products. Growing our categories with new products is one of our strengths. In 1998 we're introducing WOW! fat-free snacks and Doritos 3Ds tortilla chips and taking Frappuccino and Aquafina national in the United States. Aquafina is already among the leading bottled waters in the United States and Frappuccino is defining the cold coffee category.

and strengthen our trademark as a powerful global icon.

Creating new products. To excite consumers and fuel category growth, we've been investing in new products like: Doritos 3Ds, a three-dimensional tortilla chip; WOW! fat-free snacks made with Olean; Frappuccino, a coffee drink developed with Starbucks; and Aquafina, a branded water with wide consumer appeal.

Building a Global Portfolio. In 1997 we changed our snack packaging to create a similar look and feel around the globe. We also announced snack acquisitions in Argentina, Australia, Europe and the United States. The investments will improve our market share and give us the scale to become more profitable in key international markets. That, in turn, broadens the distribution base of our global snack portfolio. These investments will move us from number two to number one in Australia and strengthen our leadership in Argentina. In the United States, buying the Cracker Jack brand lets us "inch out" from our core salty snacks.

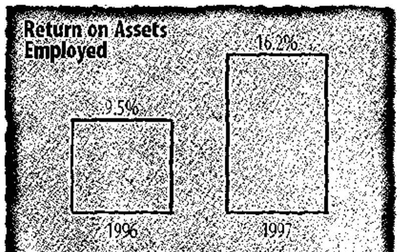


Global Packaging. As we broaden our global snack food business we're creating a consistent image.

So, that's our plan and what we accomplished – so far.

The Financial Results

Amid all the strategic progress, the new PepsiCo also produced encouraging financial results. In snacks and beverages – called "continuing operations" in the financial pages – our operating profit grew 30% and earnings per share grew 62%. Operating profit margins improved by almost three percentage points. On top of that, we invested $2.5 billion in share repurchases in 1997, and we hope to invest $3 billion in 1998.



Return on assets employed jumped dramatically after our restaurant spin-off.

And our share price? After adjusting for the spin-off, it was up 27%.

But here's the real news: The transformation of PepsiCo has put us in a much better position to achieve *long-term* financial success. Our goal, very simply, is to produce mid-teens annual earnings per share growth – consistently.

If history is any indication, that could result in similar shareholder returns. For a long-term investment, that's hard to beat.

What You Can Expect

So when all is said and done, what can the world expect from PepsiCo? Plenty.

❧ Consumers will see a lot more great advertising and terrific new products and packages. They'll also find our products more widely available.

Top Contributors to U.S. Supermarket Growth
% of Total Supermarket Sales Growth Provided: Cumulative 1995-1997

PepsiCo, Inc.	11%
The Coca-Cola Company	5%
Grand Metropolitan PLC	4%
Bristol-Myers Squibb Company	3%
Hershey Foods Corp.	2%
Campbell Soup Company	2%
ConAgra, Inc.	2%
Mars, Incorporated	2%
Sara Lee Corporation	1%
Unilever N.V.	1%

❧ Retail and foodservice customers can expect PepsiCo to continue driving their growth. We also intend to continue providing them a high return on their investment. Since 1995 we've contributed more to U.S. supermarket growth than any other packaged goods company.

❧ Employees can expect PepsiCo to continue upholding very high standards and offering great opportunities, but in an organization with a simpler structure, fewer distractions and greater continuity.

❧ Communities in which we operate can expect PepsiCo to continue being an active and supportive corporate citizen.

❧ As for our shareholders, with all we've done to focus and strengthen PepsiCo, I believe that we *can* deliver mid-teens compounded annual earnings per share growth *consistently*. Our earnings growth may vary from quarter to quarter, and beverages and snacks won't always grow at the same rate. But that's one of the great things about PepsiCo: It is a portfolio of strong businesses. I believe that portfolio is capable of producing both solid earnings and lots of cash – perhaps $6 billion in total operating cash over the next several years.

Long term, our prospects are even more exciting. If we do an excellent job satisfying our consumers, supporting our customers and

Product Portfolio. We have terrific products. Nine of our brands – Lay's, Doritos, Ruffles, Chee•tos, Pepsi, Diet Pepsi, Mountain Dew, 7UP, Mirinda – each sell over $1 billion a year at retail, making our portfolio very appealing to our customers.

investing in the things that drive growth, I believe PepsiCo will rank among the great companies of the next century.

By that I mean a company characterized by:

- relentless dedication to the people who sell and buy its products;
- strong, consistent earnings growth and healthy cash flow;
- robust sales and volume growth – from investment, market expansion, lots of innovation;
- responsible stewardship of assets;
- a reputation as a great employer, community citizen and competitor.

A Final Thought

Finally, on a personal note, I'd like to welcome Peter Foy, who joined our Board of Directors in July. Peter is chairman of Baring Brothers International Ltd., in England and spent many years as a senior executive with McKinsey & Co. Peter understands consumer product companies as well as anyone I know, and he's a great addition to our Board.

As I hope you can see, the new PepsiCo is well under way. In the spirit of Leonardo, we've tried to think about PepsiCo in new and different ways. And we've strived to create our own sort of masterpiece, one that will give our shareholders strong, consistent earnings for many years to come.

Roger A. Enrico
Chairman of the Board and
Chief Executive Officer

Principal Divisions and Corporate Officers
(Listings include age and years of PepsiCo experience.)

Executive Offices

PepsiCo, Inc.
Purchase, NY 10577
(914) 253-2000

Co-founder of PepsiCo, Inc.
Donald M. Kendall
50 years of PepsiCo experience

Corporate Officers

Roger A. Enrico
Chairman of the Board and
Chief Executive Officer
53, 26 years

Karl M. von der Heyden
Vice Chairman and Chief Financial Officer
61, 7 years

William R. Bensyl
Senior Vice President, Personnel
52, 22 years

John T. Cahill
Senior Vice President and Treasurer
40, 8 years

Joseph F. McCann
Senior Vice President, Public Affairs
57, 25 years

Matthew M. McKenna
Senior Vice President, Taxes
47, 4 years

Indra K. Nooyi
Senior Vice President, Strategic Planning
42, 4 years

Sean F. Orr
Senior Vice President and Controller
43, 3 years

Robert F. Sharpe, Jr.
Senior Vice President,
General Counsel and Secretary
46, under one year

Principal Divisions and Officers

Pepsi-Cola Company
1 Pepsi Way
Somers, New York 10589
(914) 767-6000

Craig E. Weatherup
Chairman and Chief Executive Officer
52, 23 years

Philip A. Marineau
President and Chief Executive Officer
Pepsi-Cola North America
51, under one year

Craig D. Jung
President
Pepsi-Cola Bottling Company
of North America
44, 12 years

Peter M. Thompson
President and Chief Executive Officer
Pepsi-Cola International
51, 7 years

Principal Divisions and Officers

Frito-Lay Company
7701 Legacy Drive
Plano, TX 75024
(972) 334-7000

Steven S Reinemund
Chairman and Chief Executive Officer
49, 13 years

Brock H. Leach
President and Chief Executive Officer
Frito-Lay North America
39, 15 years

James H. O'Neal
President and Chief Executive Officer
Frito-Lay International
60, 31 years

William R. McLaughlin
President Europe, Middle East,
Africa Region
41, 9 years

Rogelio Rebolledo
President Latin America and
Asia Pacific Regions
53, 21 years

PepsiCo, Inc. Board of Directors
(Listings include age and year elected PepsiCo director.)

John F. Akers
Former Chairman of the Board and Chief Executive Officer
International Business Machines Corporation
63. Elected 1991

Robert E. Allen
Former Chairman of the Board and Chief Executive Officer
AT&T Corp.
63. Elected 1990

Wayne Calloway
Former Chairman of the Board and Chief Executive Officer
PepsiCo, Inc.
62. Elected 1983

Roger A. Enrico
Chairman of the Board and Chief Executive Officer
PepsiCo, Inc.
53. Elected 1987

Peter Foy
Chairman
Baring Brothers International Ltd.
57. Elected 1997

Ray L. Hunt
Chairman and Chief Executive Officer
Hunt Oil Company
Chairman, Chief Executive Officer and President
Hunt Consolidated, Inc.
54. Elected 1996

John J. Murphy
Former Chairman of the Board and Chief Executive Officer
Dresser Industries
66. Elected 1984

Steven S Reinemund
Chairman and Chief Executive Officer
Frito-Lay Company
49. Elected 1996

Sharon Percy Rockefeller
President and Chief Executive Officer
WETA public stations, Washington, DC
53. Elected 1986

Franklin A. Thomas
Consultant
TFF Study Group
63. Elected 1994

P. Roy Vagelos
Former Chairman of the Board and Chief Executive Officer
Merck & Co.
68. Elected 1992

Karl M. von der Heyden
Vice Chairman of the Board and Chief Financial Officer
PepsiCo, Inc.
61. Elected 1996

Craig E. Weatherup
Chairman and Chief Executive Officer
Pepsi-Cola Company
52. Elected 1996

Arnold R. Weber
Chancellor
Northwestern University
68. Elected 1978

Management's Discussion and Analysis

All per share information is computed using average shares outstanding, assuming dilution.

Introduction

Management's Discussion and Analysis is presented in four sections. The introductory section discusses the 1997 Disposal of the Restaurants Segment and two pervasive issues impacting many companies, Market Risk and Year 2000 (pages 13-14). The second section analyzes the Results of Operations, first on a consolidated basis and then for each of our two industry segments (pages 14-19). The final two sections address our consolidated Cash Flows and Liquidity and Capital Resources (pages 19-20).

Cautionary Statements

From time to time, in written reports, including the Chairman's Letter accompanying this annual report, and oral statements, we discuss our expectations regarding PepsiCo's future performance. These "forward-looking statements" are based on currently available competitive, financial and economic data and our operating plans. They are also inherently uncertain, and investors must recognize that events could turn out to be significantly different from what we expect.

Disposal of the Restaurants Segment

On August 14, 1997 we announced that our Board of Directors approved a formal plan to spin off our restaurant businesses to our shareholders. Under the plan, owners of PepsiCo capital stock as of September 19, 1997 received one share of common stock of the new restaurant company, TRICON Global Restaurants, Inc. (TRICON), for every ten shares of PepsiCo capital stock. The spin-off was completed on October 6, 1997 (Distribution Date). In 1997, we also sold PepsiCo Foods Systems (PFS), the restaurant distribution operation and all of the non-core U.S. restaurant businesses. As a result, the sales, costs and expenses, assets and liabilities, and cash flows of the Restaurants segment have been classified as discontinued operations in our financial statements. See Note 4. Accordingly, the discussions that follow focus on the continuing operations of our packaged goods businesses.

Market Risk

The principal market risks (i.e., the risk of loss arising from adverse changes in market rates and prices) to which we are exposed are:
- interest rates on our debt and short-term investment portfolios;
- foreign exchange rates, generating translation and transaction gains and losses and
- commodity prices, affecting the cost of our products.

Interest Rates

PepsiCo centrally manages its debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies.

We use interest rate and currency swaps to effectively change the interest rate and currency of specific debt issuances with the objective of reducing our overall borrowing costs. These swaps are generally entered into concurrently with the issuance of the debt they are intended to modify. The notional amount, interest payment and maturity dates of the swaps match the principal, interest payment and maturity dates of the related debt. Accordingly, any market risk or opportunity associated with these swaps is offset by the opposite market impact on the related debt.

Our investment portfolios consist of cash equivalents and short-term marketable securities; accordingly, the carrying amounts approximate market value. It is our practice to hold these investments to maturity.

Assuming year-end 1997 variable rate debt and investment levels, a one-point change in interest rates would impact net interest expense by $13 million.

Foreign Exchange

Operating in international markets sometimes involves exposure to volatile movements in currency exchange rates. The economic impact of currency exchange rate movements on us is complex because such changes are often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, can cause us to adjust our financing and operating strategies. Consequently, isolating the effect of changes in currency does not incorporate these other important economic factors.

International operations constitute about 16% of our 1997 consolidated operating profit, excluding unusual items. As currency exchange rates change, translation of the income statements of our international businesses into U.S. dollars affects year-over-year comparability of operating results. We do not generally hedge translation risks because cash flows from international operations are generally reinvested locally. We do not enter into hedges to minimize volatility of reported earnings because we do not believe it is justified by the exposure or the cost.

Changes in currency exchange rates that would have the largest impact on translating our international operating profit include the Mexican peso, British pound, Canadian dollar and Brazilian real. We estimate that a 10% change in foreign exchange rates would impact reported operating profit by less than $50 million. This represents 10% of the international segment operating profit (disclosed on page 33) after adjusting for unusual items. We believe that this quantitative measure has inherent limitations because, as discussed in the first paragraph of this section, it does not take into account any governmental actions or changes in either customer purchasing patterns or our financing and operating strategies.

Foreign exchange gains and losses reflect transaction gains and losses and translation gains and losses arising from the remeasurement into U.S. dollars of the net monetary assets of businesses in highly inflationary countries. Transaction gains and losses arise from monetary assets and liabilities denominated in currencies other than a business unit's functional currency. Net foreign exchange gains and losses were not material to our earnings for the last three years.

The sensitivity analyses presented in the interest and foreign exchange discussions above disregard the possibility that rates can move in opposite directions and that gains from one category may or may not be offset by losses from another category and vice versa.

Commodities

We are subject to market risk with respect to commodities because our ability to recover increased costs through higher pricing may be limited by the competitive environment in which we operate. We use futures contracts to hedge immaterial amounts of our commodity purchases.

Year 2000

The Year 2000 issue is the result of computer programs using two digits rather than four to define the applicable year. Computer programs that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations leading to disruptions in a company's operations. If either we, our significant customers or suppliers fail to correct Year 2000 issues, such failure could have a significant impact on our ability to operate our businesses. However, the impact cannot be quantified at this time.

We are in the process of taking actions to address and complete the work associated with the Year 2000. Each of our business segments and Corporate have established teams to identify and correct Year 2000 issues. Internal software with non-compliant code is expected to be fixed or replaced with software that is Year 2000 compliant. Similar attention is being given to technology infrastructures, manufacturing plants and building facilities to achieve compliance in all these areas. The teams are also charged with investigating the Year 2000 capabilities of suppliers, customers and other external entities, and with developing contingency plans where necessary.

An inventory and assessment of all computer systems and application software have been completed, and plans for establishing compliance have been developed in the United States. These plans identify which non-compliant hardware and software will be corrected, upgraded or replaced; the timetable and resource requirements to achieve those objectives and estimated associated costs. Remediation and testing activities are under way at both Pepsi-Cola and Frito-Lay. Most of our larger international operations have made similar progress, while some of our smaller international operations, which are generally less automated, are still developing their strategies.

We do not expect Year 2000 spending to materially affect consolidated profitability or liquidity. This expectation assumes that our existing forecast of costs to be incurred contemplates all significant actions required and that we will not be obligated to incur significant Year 2000 related costs on behalf of our customers or suppliers. About 40% of the total estimated spending represents replacement systems that, in addition to being Year 2000 compliant, provide significantly enhanced capability which will benefit operations in future years.

Results of Operations

Consolidated Review

Net Sales rose $580 million or 3% in 1997, reflecting volume gains, partially offset by the impact of unfavorable currency translation. Net sales rose $1.3 billion or 7% in 1996, reflecting net volume gains and higher effective net pricing (including the effect of product, package and country mix) in both of our business segments. These gains were partially offset by an unfavorable foreign currency translation impact. Volume gains in both years were driven by worldwide Snack Foods and North American Beverages.

Cost of sales as a percent of net sales decreased .8 of a point to 40.8% in 1997, primarily reflecting favorable raw material costs in International Beverages, and the leveraging effect of higher pricing partially offset by increased costs for new plant capacity and the planned introduction of new products in 1998 by North American Snack Foods. Cost of sales as a percent of net sales decreased .6 of a point to 41.6% in 1996 primarily due to lower raw materials costs in North American Beverages coupled with the leveraging effect of the higher effective net pricing.

Selling, general and administrative expenses (SG&A) comprises selling and distribution expenses (S&D), advertising and marketing expenses (A&M), general and administrative expenses (G&A), other income and expense and equity income or loss from investments in unconsolidated affiliates. In 1997, SG&A grew 2%, or at a slower rate than sales. This primarily reflects equity income from our investments in unconsolidated affiliates, compared to losses a year ago, and A&M growing at a significantly slower rate than sales. The change in equity income primarily reflects the absence of losses from our Latin American bottler, Buenos Aires Embotelladora S.A. (BAESA). G&A grew significantly faster than sales, reflecting information systems-related expenses, customer focus leadership training and infrastructure costs related to our new fountain beverage sales team. These increased expenses were partially offset by savings from a prior year restructuring and the consolidation of certain administrative functions.

In 1996, A&M and S&D grew faster than net sales, driving an 11% increase in SG&A, led by International Beverages. Equity losses from our unconsolidated affiliates, compared to equity income in 1995, primarily reflect our share of operating losses from BAESA.

Amortization of intangible assets declined 3% to $199 million and 1% to $206 million in 1997 and 1996, respectively.

Unusual items of $290 million ($239 million after-tax or $0.15 per share) in 1997 and $576 million ($527 million after-tax or $0.33 per share) in 1996 relate to decisions to dispose of and write down assets, improve productivity and strengthen the international bottler structure. See Note 2. The 1995 charge of $66 million ($64 million after-tax or $0.04 per share) is the initial, noncash impairment charge upon adoption of Statement of Financial Accounting Standards No. 121 (SFAS 121), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." See Note 3.

Operating Profit

($ in millions)	1997	1996	1995	% Growth Rates 1997	1996
Operating Profit					
Reported	**$2,662**	$2,040	$2,606	**30**	(22)
Ongoing	**$2,952**	$2,616	$2,672	**13**	(2)

Ongoing excludes the effect of the unusual items (see Note 2).

In 1997, reported operating profit increased $622 million. Ongoing operating profit increased $336 million reflecting segment operating profit growth of $392 million or 14%, partially offset by a $56 million or 32% increase in unallocated expenses. The increase in segment operating profit primarily reflects the volume gains and lower raw material costs in worldwide Beverages. The increase in unallocated expenses relates to higher corporate expenses and foreign exchange losses in 1997 compared to gains in 1996.

In 1996, reported operating profit declined $566 million. Ongoing operating profit decreased $56 million due to a $30 million or 21% increase in unallocated expenses and a combined segment operating profit decrease of $26 million or 1%. The increased unallocated expenses relate to centrally administered benefit plans and higher corporate expenses. The decline in segment operating profit reflects increased costs in excess of higher effective net pricing, partially offset by volume gains. The change in ongoing segment operating profit also includes unfavorable currency translation impacts.

Interest expense, net of interest income declined $121 million or 26%. Interest expense declined $87 million or 15% in 1997, primarily reflecting lower average U.S. debt levels. Debt levels were reduced using a portion of the cash flows provided by discontinued operations and proceeds repatriated from our investments in Puerto Rico. The repatriation of funds resulted from a 1996 change in tax law which eliminated a tax exemption on investment income in Puerto Rico. Interest income increased $34 million or 37% reflecting higher average investment levels, which also benefited from cash flows provided by discontinued operations.

Interest expense, net of interest income in 1996 declined $41 million or 8%, reflecting lower international debt levels and U.S. interest rates.

Provision for Income Taxes

($ in millions)	1997	1996	1995
Reported			
Provision for income taxes	**$818**	$ 624	$ 669
Effective tax rate	**35.4%**	39.8%	32.0%
Ongoing			
Provision for income taxes	**$869**	$ 673	$ 671
Effective tax rate	**33.4%**	31.4%	31.1%

Ongoing excludes the effect of the unusual items (see Note 2).

Our 1997 reported effective tax rate decreased 4.4 points to 35.4%. Our ongoing effective tax rate increased 2.0 points to 33.4%, primarily reflecting the absence of cumulative tax credits recognized in 1996 that related to prior years, lower benefits in 1997 from the current year resolution of prior years' audit issues and other individually immaterial items.

Our 1996 reported effective tax rate increased 7.8 points to 39.8%. Our ongoing effective tax rate remained about even with the prior year as lower benefits from the current year resolution of prior years' audit issues were offset by the cumulative tax credits related to prior years and other individually immaterial items.

Income from Continuing Operations and Income per Share

($ in millions except per share amounts)	1997	1996	1995	% Growth Rates 1997	1996
Income from continuing operations					
Reported	**$1,491**	$ 942	$1,422	**58**	(34)
Ongoing	**$1,730**	$1,469	$1,486	**18**	(1)
Income per share from continuing operations*					
Reported	**$ 0.95**	$ 0.59	$ 0.88	**62**	(34)
Ongoing	**$ 1.10**	$ 0.92	$ 0.92	**20**	(1)

Ongoing excludes the effect of the unusual items (see Note 2).

* The percentage change in income per share is calculated by using income per share calculated to four decimal places in order to eliminate the effects of rounding.

Income from Discontinued Operations and Income per Share

($ in millions except per share amounts)	1997	1996	1995	% Growth Rates 1997	% Growth Rates 1996
Income from discontinued operations	**$ 651**	$ 207	$ 184	**NM**	13
Income per share from discontinued operations*	**$0.41**	$ 0.13	$0.12	**NM**	13

* The percentage change in income per share is calculated by using income per share calculated to four decimal places in order to eliminate the effects of rounding.
NM – Not Meaningful

Income from discontinued operations reflects the operating results of TRICON's core restaurant businesses of Pizza Hut, KFC and Taco Bell through the Distribution Date, as well as PFS, the restaurant distribution operation sold in the second quarter, and several non-core U.S. restaurant businesses through their respective disposal dates in 1997. Reported operating results include expenses associated with the spin-off and interest expense directly related to the Restaurants segment. It does not include an allocation of PepsiCo interest expense or G&A. It also includes the 1997 gain from the sale of PFS. (See Note 4.)

Net Income and Income per Share

($ in millions except per share amounts)	1997	1996	1995	% Growth Rates 1997	% Growth Rates 1996
Net income	**$2,142**	$1,149	$1,606	**86**	(28)
Net income per share*	**$ 1.36**	$ 0.72	$ 1.00	**91**	(28)
Average shares outstanding used to calculate net income per share	**1,570**	1,606	1,608	**(2)**	–

* The percentage change in income per share is calculated by using income per share calculated to four decimal places in order to eliminate the effects of rounding.

Industry Segments

($ in millions)	1997	1996	1995	1994	1993
NET SALES					
Beverages					
North America (a)	**$ 7,852**	$ 7,734	$ 7,427	$ 7,045	$ 6,464
International	**2,689**	2,853	3,040	2,609	2,168
	10,541	10,587	10,467	9,654	8,632
Snack Foods					
North America (a)	**6,967**	6,628	5,873	5,379	4,686
International	**3,409**	3,122	2,727	2,951	2,388
	10,376	9,750	8,600	8,330	7,074
Combined Segments	**$20,917**	$20,337	$19,067	$17,984	$15,706
OPERATING PROFIT (b)					
Beverages					
North America (a)	**$ 1,297**	$ 1,412	$ 1,238	$ 1,104	$ 1,012
International	**(137)**	(830)	128	147	104
	1,160	582	1,366	1,251	1,116
Snack Foods					
North America (a)	**1,414**	1,286	1,149	1,043	914
International	**318**	346	301	354	285
	1,732	1,632	1,450	1,397	1,199
Combined Segments	**2,892**	2,214	2,816	2,648	2,315
Adjustments					
Equity (income)/loss from unconsolidated affiliates	**(84)**	274	(38)	(52)	(31)
Other (c)	**1**	10	(37)	(2)	15
Total Adjustments	**(83)**	284	(75)	(54)	(16)
Combined Segments – SFAS 14 Basis (d)	**$ 2,809**	$ 2,498	$ 2,741	$ 2,594	$ 2,299

(a) North America is composed of operations in the U.S. and Canada.
(b) Represents reported amounts. See Note 2 – Unusual Items Affecting Comparability for 1997 and 1996. In addition, 1995 segment operating profit excludes the $66 charge for the initial, noncash impact of adopting SFAS 121 and 1994 International Beverages includes an $18 gain on a stock offering by BAESA.
(c) Adjustments directly allocable to industry segments for SFAS 14 purposes but reported in Corporate. Adjustments include the $66 SFAS 121 charge in 1995 and elimination of the $18 gain on the stock offering by BAESA in 1994.
(d) Operating profit as defined by SFAS 14 and as disclosed in Note 17.

Beverages

($ in millions)	1997	1996	1995	% Growth Rates 1997	1996
Net Sales					
North America	**$ 7,852**	$ 7,734	$ 7,427	**2**	4
International	**2,689**	2,853	3,040	**(6)**	(6)
	$10,541	$10,587	$10,467	**–**	1
Operating Profit					
Reported					
North America	**$ 1,297**	$ 1,412	$ 1,238	**(8)**	14
International	**(137)**	(830)	128	**83**	NM
	$ 1,160	$ 582	$ 1,366	**99**	(57)
Ongoing					
North America	**$ 1,349**	$ 1,412	$ 1,238	**(4)**	14
International	**17**	(254)	128	**NM**	NM
	$ 1,366	$ 1,158	$ 1,366	**18**	(15)

Ongoing excludes unusual items of $206 ($52-North America, $154-International) in 1997 and $576 (all International) in 1996 (see Note 2). Unless otherwise noted, operating profit comparisons within the following discussions are based on ongoing operating profit.
NM – Not Meaningful

System bottler case sales (BCS) is our standard volume measure. It represents PepsiCo-owned brands as well as brands we have been granted the right to produce, distribute and market nationally.

1997 vs. 1996

North America
Net sales increased $118 million reflecting volume growth, led by take-home packaged products, partially offset by lower effective net pricing. The decrease in effective net pricing was primarily in take-home packaged products, reflecting an intensely competitive environment.

BCS increased 4%, primarily reflecting double-digit growth by the Mountain Dew brand. Non-carbonated soft drink products, led by Aquafina bottled water and Lipton Brisk tea, grew at a double-digit rate. Our concentrate shipments to franchisees grew at a slower rate than their BCS growth during the year.

Reported operating profit declined $115 million. Ongoing operating profit declined $63 million, reflecting the lower effective net pricing, higher S&D costs and increased A&M. S&D grew significantly faster than sales, but in line with volume. A&M grew significantly faster than sales and volume, primarily reflecting above average levels of expenditures late in 1997. These unfavorable items were partially offset by the volume gains and lower packaging and commodity costs. G&A savings from centralizing certain administrative functions were fully offset by Year 2000 spending and infrastructure development costs related to our new fountain beverage sales team. The decline in ongoing operating profit also reflects lapping 1996 gains from the sale of an investment in a bottling cooperative and a settlement made with a supplier.

International
Net sales declined $164 million. The decline was due to unfavorable currency translation effects, primarily driven by Spain and Japan.

BCS increased 1%. Strong double-digit growth in China, the Philippines and India was partially offset by double-digit declines in Brazil, Venezuela and South Africa. The declines in Venezuela and South Africa reflect the impact of the unexpected loss of our bottler in August 1996 and the cessation of our joint venture operation, respectively. In November 1996, we entered into a new joint venture to replace the Venezuelan bottler. Total concentrate shipments to franchisees increased at about the same rate as their BCS.

Reported operating losses declined $693 million. Ongoing operating results improved by $271 million, reflecting a small profit in 1997 compared to a loss in 1996. The increase in ongoing operating results was driven by lower manufacturing costs, reduced net losses from our investments in unconsolidated affiliates and lower G&A expenses. Operating results also benefited from the lapping of 1996's higher-than-normal expenses from fourth quarter balance sheet adjustments and actions. The lower manufacturing costs were primarily due to favorable raw material costs and lower depreciation resulting from certain businesses held for disposal. The reduced net losses from our unconsolidated affiliates were primarily driven by the absence of losses from BAESA. The lower G&A expenses reflect savings from our fourth quarter 1996 restructuring of about $70 million.

1996 vs. 1995

North America
Net sales rose $307 million. The gain reflects volume growth, led by carbonated soft drink products, and higher effective net pricing.

BCS increased 4%, with solid increases in Brand Pepsi and the Mountain Dew brand. Non-carbonated soft drink products, led by Aquafina bottled water and Hawaiian Punch fountain syrup, grew at a double-digit rate. Our concentrate shipments to franchisees grew at a slightly faster rate than their BCS growth.

Operating profit increased $174 million. The growth reflects the volume gains, lower product costs and the higher effective net pricing. A&M expenses grew significantly faster than sales, primarily due to the Pepsi Stuff promotion. S&D expenses grew at the same rate as sales and volume. Profit growth was aided by lapping charges taken in 1995, primarily for losses on supply contracts, take-or-pay co-packing penalties and a write down of excess co-packing assets. A 1996 gain on the sale of an investment in a bottling cooperative and a 1996 settlement with a supplier for purchases made in prior years also helped profit growth.

Benefits of approximately $130 million related to the 1992 U.S. restructuring were achieved in 1996 due to the centralization of purchasing and improved administrative and business processes. All benefits from the restructuring will be reinvested in the business.

International
In 1996 we began to implement a new strategy to focus on building our core business in markets in which we are already strong and in certain emerging markets. Decisions were made accordingly to dispose of certain businesses and to restructure operations, resulting in unusual impairment and restructuring charges. Liabilities associated with the restructuring charge were expected to be paid by the end of 1997 and the restructuring

was expected to generate about $50 million in savings in 1997 and about $80 million a year thereafter.

Net sales declined $187 million, primarily due to unfavorable currency translation impacts and lower volume. The volume decline reflects lower concentrate shipments to franchisees, partially offset by higher packaged product sales to retailers.

BCS decreased 2%. Excluding the impact of the unexpected loss of our Venezuelan bottler, BCS declined 1%. A single-digit decline in Latin America was partially offset by strong double-digit growth in China and India. Our concentrate shipments to franchisees declined at a significantly faster rate than their BCS decline.

Reported operating results declined $958 million. Ongoing operating results declined $382 million. The decline reflects broad-based increases in A&M, higher-than-normal expenses from fourth quarter balance sheet adjustments and actions, increased net losses from our unconsolidated affiliates and a decline in volume. The increased net losses from our unconsolidated affiliates were driven by our equity share of BAESA's operating losses.

Snack Foods

($ in millions)	1997	1996	1995	% Growth Rates 1997	1996
Net Sales					
North America	**$ 6,967**	$6,628	$5,873	**5**	13
International	**3,409**	3,122	2,727	**9**	14
	$10,376	$9,750	$8,600	**6**	13
Operating Profit					
Reported					
North America	**$ 1,414**	$1,286	$1,149	**10**	12
International	**318**	346	301	**(8)**	15
	$ 1,732	$1,632	$1,450	**6**	13
Ongoing					
North America	**$ 1,436**	$1,286	$1,149	**12**	12
International	**380**	346	301	**10**	15
	$ 1,816	$1,632	$1,450	**11**	13

Ongoing excludes unusual charges of $84 ($22-North America, $62-International) in 1997 (see Note 2). Unless otherwise noted, operating profit comparisons within the following discussions are based on ongoing operating profit.

Pound and kilo sales are our standard volume measures. Pound and kilo growth are reported on a systemwide basis, which includes both consolidated businesses and unconsolidated affiliates operating for at least one year.

1997 vs. 1996

North America

Net sales grew $339 million reflecting increased volume and the benefit of higher pricing taken on most major brands late in 1996.

Pound volume advanced 3%. Growth of our core brands, excluding their low-fat and no-fat versions, was led by high single-digit growth in Lay's brand potato chips, strong double-digit growth by Tostitos brand tortilla chips and single-digit growth by Doritos brand tortilla chips. Baked Lay's brand potato crisps reported low double-digit growth; however, the remainder of our low-fat and no-fat snacks business depressed the overall growth rate.

Reported operating profit grew $128 million. Ongoing operating profit rose $150 million, reflecting the higher pricing and volume growth, partially offset by increased manufacturing costs and G&A expenses. The increased manufacturing costs relate to new plant capacity and the planned introduction of new products in 1998. S&D grew slower than sales, A&M was about even with prior year and G&A increased significantly faster than sales reflecting information systems-related expenses and customer focus leadership training. Operating profit growth was hampered by lapping a 1996 gain from the sale of a non-core business.

International

Net sales increased $287 million reflecting volume gains and higher effective net pricing.

Salty snack kilos rose 11%, led by strong double-digit growth by Sabritas and our business in Brazil, while sweet snack kilos declined 5%, due to a market contraction at Gamesa.

Reported operating profit decreased $28 million. Ongoing operating profit increased $34 million. The increase primarily reflects volume gains partially offset by increased G&A. The higher effective net pricing was fully offset by inflation-driven higher operating and manufacturing costs, primarily in Mexico. Ongoing operating profit also benefited from the gain on the sale of a flour mill.

1996 vs. 1995

North America

Net sales grew $755 million. The increase reflects strong volume growth and higher effective net pricing taken across all core brands in late 1995 and late 1996.

Pound volume advanced 9%, reflecting exceptional performance from the low-fat and no-fat categories. These categories contributed over 45% of the total pound growth, led by Baked Lay's brand potato crisps. Core brands, excluding their low-fat and no-fat versions, had mid-single-digit growth led by double-digit growth in Lay's brand potato chips and strong double-digit growth in Tostitos brand tortilla chips.

Operating profit grew $137 million. The increase reflects the volume growth and the higher effective net pricing, which exceeded increased promotional price allowances and merchandising support. The growth rate of promotional price allowances moderated in the fourth quarter. These gains were partially offset by higher operating and manufacturing costs and increased administrative expenses. The increased operating costs reflect increased S&D and A&M. S&D and manufacturing costs both reflect capacity costs and some inefficiencies incurred to capture the volume opportunities created when Anheuser-Busch exited the salty snack food business. These inefficiencies began to moderate in the fourth quarter. The increase in operating expenses coupled with higher G&A expenses, partially reflect investment spending to sustain strong volume growth. This increased investment spending, including costs of developing and testing new products, was partially offset by a gain on the sale of a non-core business.

International
Net sales increased $395 million. This growth reflects inflation-based price increases in Mexico and volume growth, partially offset by an unfavorable currency translation impact, led by the peso.

Salty snack kilos rose 8%, reflecting double-digit growth at Sabritas and strong single-digit growth in the U.K. Sweet snack kilos declined 2%, led by a single-digit decline at Gamesa, due to marketwide contraction, and a double-digit decline at Alegro, the sweet snack division of Sabritas.

Operating profit increased $45 million. The increase reflects higher effective net pricing in advance of inflation-driven product and operating cost increases, primarily in Mexico, and the increased volumes. These gains were partially offset by increased administrative expenses and the net unfavorable currency translation impact. A&M expenses increased, partially reflecting investment in global advertising and design.

Consolidated Cash Flows

PepsiCo's 1997 consolidated cash and cash equivalents increased $1.6 billion over the prior year reflecting a significant increase in cash provided by discontinued operations, partially offset by increased cash outflows to reduce debt, increase our investment portfolios and repurchase shares.

Net cash provided by operating activities rose $227 million or 7% to $3.4 billion in 1997, driven by increased income before all noncash charges and credits. Cash flow growth from operating working capital was reduced by the year-over-year change in accounts payable and other current liabilities, primarily due to lapping restructuring accruals recorded in the fourth quarter of 1996.

Net cash used for investing activities nearly doubled in 1997 to $2.1 billion, primarily reflecting a $1.5 billion swing in our short-term investment portfolio activity, partially offset by $178 million of increased proceeds from sales of businesses and reduced capital spending of $124 million. The change in our short-term investment portfolio activity primarily reflects investing a portion of the cash flows provided by discontinued operations. This compares to 1996 when we repatriated the proceeds from our maturing investments in Puerto Rico as a result of the Small Business Job Protection Act of 1996. This tax law eliminated our exemption from U.S. Federal income tax on investment income generated in Puerto Rico. The repatriated proceeds were used to reduce outstanding commercial paper debt. The cash flow from sales of businesses in 1997 primarily reflects the sale of international bottling operations and our investment in a non-core international snack food business. Lower capital spending was driven by North American Snack Foods. The decline reflects the lapping of 1996 capital spending incurred to capture volume opportunities created when Anheuser-Busch exited the salty snack food business, partially offset by 1997 new product-related spending. Spending on acquisitions and investments in unconsolidated affiliates is expected to increase in 1998.

Net cash used for financing activities more than doubled to $6.0 billion in 1997. The increase primarily reflects increased net debt repayments of $2.5 billion and share repurchases.

Share repurchase activity:

(in millions)	**1997**	1996	1995
Cost	**$2,459**	$1,651	$541
Shares repurchased			
Number of shares	**69.0**	54.2	24.6
% of shares outstanding at beginning of year	**4.5%**	3.4%	1.6%

At December 27, 1997, 132 million shares were available under the current repurchase authority granted by our Board of Directors.

Net cash flow provided by discontinued operations increased $5.6 billion in 1997. The significant increase primarily reflects a $4.5 billion cash distribution received from TRICON just prior to the Restaurant spin-off. In addition, it reflects after-tax cash proceeds of $1.0 billion associated with the sale of PFS and the non-core U.S. restaurant businesses, the effects of refranchising restaurants and other operating activities.

Free Cash Flow

Free cash flow is a measure we use internally to evaluate our cash flow performance and should be considered in addition to, but not as a substitute for, other measures of financial performance in accordance with generally accepted accounting principles. These funds provide us with flexibility to reduce our debt outstanding, repurchase shares or make strategic investments and acquisitions.

($ in millions)	**1997**	1996	1995
Earnings before interest, taxes, depreciation and amortization*	**$ 4,001**	$ 3,479	$ 3,718
Interest expense, net	**(353)**	(474)	(515)
Provision for income taxes	**(818)**	(624)	(669)
Other noncash items and working capital	**589**	811	108
Net cash provided by operating activities	**3,419**	3,192	2,642
Investing activities			
Capital spending	**(1,506)**	(1,630)	(1,365)
Sales of businesses	**221**	43	14
Sales of property, plant and equipment	**80**	9	93
Other, net	**(96)**	(214)	(229)
Free cash flow before cash dividends paid	**2,118**	1,400	1,155
Cash dividends paid	**(736)**	(675)	(599)
Free cash flow			
Continuing operations	**1,382**	725	556
Discontinued operations	**6,236**	605	506
	$ 7,618	$ 1,330	$ 1,062

* Net of the noncash portion of unusual items.

The $6.3 billion increase in free cash flow in 1997 largely reflects our strategic initiative to exit the restaurant business. In addition, free cash flow from continuing operations nearly doubled with improved cash flows from operating activities, larger proceeds arising from the sale of businesses and reduced capital spending. Both continuing and discontinued operations contributed to the $268 million or 25% increase in the 1996 free cash flow.

Liquidity and Capital Resources

At year-end 1997, $2.1 billion of short-term borrowings were reclassified as long-term, reflecting our intent and ability, through the existence of our unused revolving credit facilities, to refinance these borrowings. Our unused credit facilities, which exist largely to support the issuances of short-term debt, were $2.75 billion and $3.5 billion at year-end 1997 and 1996, respectively. Annually, these facilities can be extended an additional year upon the mutual consent of PepsiCo and the lending institutions. We reduced our credit facilities by $750 million at year-end 1997 due to decreased borrowing needs.

Our net debt level, which reflects the pro forma remittance of investment portfolios (net of related taxes) as a reduction of total debt, and leverage at year-end 1997 were lower than prior years. We plan to gradually releverage over time.

Our strong cash-generating capability and financial condition give us ready access to capital markets throughout the world.

Consolidated Statement of Income

(in millions except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 27, 1997, December 28, 1996 and December 30, 1995

	1997	1996	1995
Net Sales	**$20,917**	$20,337	$19,067
Costs and Expenses, net			
Cost of sales	**8,525**	8,452	8,054
Selling, general and administrative expenses	**9,241**	9,063	8,133
Amortization of intangible assets	**199**	206	208
Unusual items	**290**	576	66
Operating Profit	**2,662**	2,040	2,606
Interest expense	**(478)**	(565)	(629)
Interest income	**125**	91	114
Income from Continuing Operations Before Income Taxes	**2,309**	1,566	2,091
Provision for Income Taxes	**818**	624	669
Income from Continuing Operations	**1,491**	942	1,422
Income from Discontinued Operations, net of tax	**651**	207	184
Net Income	**$ 2,142**	$ 1,149	$ 1,606
Income Per Share – Basic			
Continuing Operations	**$ 0.98**	$ 0.60	$ 0.90
Discontinued Operations	**0.42**	0.13	0.12
Net Income	**$ 1.40**	$ 0.73	$ 1.02
Average shares outstanding	**1,528**	1,564	1,576
Income Per Share – Assuming Dilution			
Continuing Operations	**$ 0.95**	$ 0.59	$ 0.88
Discontinued Operations	**0.41**	0.13	0.12
Net Income	**$ 1.36**	$ 0.72	$ 1.00
Average shares outstanding	**1,570**	1,606	1,608

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows

(in millions)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 27, 1997, December 28, 1996 and December 30, 1995

	1997	1996	1995
Cash Flows – Operating Activities			
Income from continuing operations	**$ 1,491**	$ 942	$ 1,422
Adjustments to reconcile income from continuing operations to net cash provided by operating activities			
Depreciation and amortization	**1,106**	1,073	1,046
Noncash portion of unusual items	**233**	366	66
Deferred income taxes	**51**	160	119
Other noncash charges and credits, net	**342**	505	585
Changes in operating working capital, excluding effects of acquisitions and dispositions			
Accounts and notes receivable	**(53)**	(67)	(182)
Inventories	**79**	(97)	(83)
Prepaid expenses, deferred income taxes and other current assets	**(56)**	84	59
Accounts payable and other current liabilities	**84**	297	(2)
Income taxes payable	**142**	(71)	(388)
Net change in operating working capital	**196**	146	(596)
Net Cash Provided by Operating Activities	**3,419**	3,192	2,642
Cash Flows – Investing Activities			
Capital spending	**(1,506)**	(1,630)	(1,365)
Acquisitions and investments in unconsolidated affiliates	**(119)**	(75)	(400)
Sales of businesses	**221**	43	14
Sales of property, plant and equipment	**80**	9	93
Short-term investments, by original maturity			
More than three months-purchases	**(92)**	(115)	(285)
More than three months-maturities	**177**	192	333
Three months or less, net	**(735)**	736	(2)
Other, net	**(96)**	(214)	(229)
Net Cash Used for Investing Activities	**(2,070)**	(1,054)	(1,841)
Cash Flows – Financing Activities			
Proceeds from issuances of long-term debt	**–**	1,772	2,027
Payments of long-term debt	**(1,875)**	(1,432)	(939)
Short-term borrowings, by original maturity			
More than three months-proceeds	**146**	740	2,053
More than three months-payments	**(177)**	(1,873)	(2,711)
Three months or less, net	**(1,269)**	89	(782)
Cash dividends paid	**(736)**	(675)	(599)
Share repurchases	**(2,459)**	(1,651)	(541)
Proceeds from exercises of stock options	**403**	323	252
Other, net	**5**	(9)	(7)
Net Cash Used for Financing Activities	**(5,962)**	(2,716)	(1,247)
Net Cash Provided by Discontinued Operations	**6,236**	605	506
Effect of Exchange Rate Changes on Cash and Cash Equivalents	**(2)**	(5)	(5)
Net Increase in Cash and Cash Equivalents	**1,621**	22	55
Cash and Cash Equivalents – Beginning of Year	**307**	285	230
Cash and Cash Equivalents – End of Year	**$ 1,928**	$ 307	$ 285
Supplemental Cash Flow Information			
Interest paid	**$ 462**	$ 538	$ 621
Income taxes paid	**$ 696**	$ 611	$ 741

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheet

(in millions except per share amount)
PepsiCo, Inc. and Subsidiaries
December 27, 1997 and December 28, 1996

	1997	1996
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 1,928**	$ 307
Short-term investments, at cost	**955**	289
	2,883	596
Accounts and notes receivable, less allowance: $125 in 1997 and $166 in 1996	**2,150**	2,276
Inventories	**732**	853
Prepaid expenses, deferred income taxes and other current assets	**486**	225
Total Current Assets	**6,251**	3,950
Property, Plant and Equipment, net	**6,261**	6,086
Intangible Assets, net	**5,855**	6,036
Investments in Unconsolidated Affiliates	**1,201**	1,147
Other Assets	**533**	491
Net Assets of Discontinued Operations	**–**	4,450
Total Assets	**$20,101**	$22,160
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and other current liabilities	**$ 3,617**	$ 3,378
Income taxes payable	**640**	413
Total Current Liabilities	**4,257**	3,791
Long-term Debt	**4,946**	8,174
Other Liabilities	**2,265**	1,997
Deferred Income Taxes	**1,697**	1,575
Shareholders' Equity		
Capital stock, par value 1 2/3¢ per share: authorized 3,600 shares, issued 1,726 shares	**29**	29
Capital in excess of par value	**1,314**	1,201
Retained earnings	**11,567**	9,184
Currency translation adjustment	**(988)**	(768)
	11,922	9,646
Less: Treasury stock, at cost: 224 shares and 181 shares in 1997 and 1996, respectively	**(4,986)**	(3,023)
Total Shareholders' Equity	**6,936**	6,623
Total Liabilities and Shareholders' Equity	**$20,101**	$22,160

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Shareholders' Equity

(in millions except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 27, 1997, December 28, 1996 and December 30, 1995

	Capital Stock							
	Issued		Treasury		Capital in Excess of Par Value	Retained Earnings	Currency Translation Adjustment	Total
	Shares	Amount	Shares	Amount				
Shareholders' Equity, December 31, 1994	1,726	$ 29	(146)	$ (1,361)	$ 920	$ 7,739	$ (471)	$ 6,856
1995 Net income	–	–	–	–	–	1,606	–	1,606
Cash dividends declared (per share–$0.39)	–	–	–	–	–	(615)	–	(615)
Currency translation adjustment	–	–	–	–	–	–	(337)	(337)
Share repurchases	–	–	(24)	(541)	–	–	–	(541)
Stock option exercises, including tax benefits of $91	–	–	20	218	125	–	–	343
Other	–	–	–	1	–	–	–	1
Shareholders' Equity, December 30, 1995	1,726	$ 29	(150)	$ (1,683)	$ 1,045	$ 8,730	$ (808)	$ 7,313
1996 Net income	–	–	–	–	–	1,149	–	1,149
Cash dividends declared (per share–$0.445)	–	–	–	–	–	(695)	–	(695)
Currency translation adjustment	–	–	–	–	–	–	40	40
Share repurchases	–	–	(54)	(1,651)	–	–	–	(1,651)
Stock option exercises, including tax benefits of $145	–	–	23	310	158	–	–	468
Other	–	–	–	1	(2)	–	–	(1)
Shareholders' Equity, December 28, 1996	1,726	$ 29	(181)	$ (3,023)	$ 1,201	$ 9,184	$ (768)	$ 6,623
1997 Net income	**–**	**–**	**–**	**–**	**–**	**2,142**	**–**	**2,142**
Cash dividends declared (per share–$0.49)	**–**	**–**	**–**	**–**	**–**	**(746)**	**–**	**(746)**
Currency translation adjustment	**–**	**–**	**–**	**–**	**–**	**–**	**(220)**	**(220)**
Share repurchases	**–**	**–**	**(69)**	**(2,459)**	**–**	**–**	**–**	**(2,459)**
Stock option exercises, including tax benefits of $173	**–**	**–**	**25**	**488**	**88**	**–**	**–**	**576**
Spin-off of restaurant businesses	**–**	**–**	**–**	**–**	**–**	**987**	**–**	**987**
Other	**–**	**–**	**1**	**8**	**25**	**–**	**–**	**33**
Shareholders' Equity, December 27, 1997	**1,726**	**$29**	**(224)**	**$(4,986)**	**$1,314**	**$11,567**	**$(988)**	**$ 6,936**

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(tabular dollars in millions except per share amounts; all per share amounts assume dilution)

Note 1 – Summary of Significant Accounting Policies
The preparation of the Consolidated Financial Statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain reclassifications were made to prior year amounts to conform with the 1997 presentation, including classifying our Restaurants segment as discontinued operations. The consolidated financial statements for all years have been restated. See Note 4.

Principles of Consolidation. The financial statements reflect the consolidated accounts of PepsiCo, Inc. and its controlled affiliates. Intercompany accounts and transactions have been eliminated. Investments in unconsolidated affiliates in which PepsiCo exercises significant influence but not control are accounted for by the equity method and PepsiCo's share of the net income or loss of its unconsolidated affiliates is included in selling, general and administrative expenses.

Marketing Costs. Marketing costs are reported in selling, general and administrative expenses and include costs of advertising and other marketing activities. Marketing costs not deferred at year-end are charged to expense ratably in relation to sales over the year in which incurred. Advertising expenses were \$1.8 billion, \$1.8 billion and \$1.4 billion in 1997, 1996 and 1995, respectively. Advertising expenses deferred at year-end, which are classified as prepaid expenses in the Consolidated Balance Sheet, were \$53 million and \$37 million in 1997 and 1996, respectively. Deferred advertising consists of media and personal service advertising-related prepayments, promotional materials in inventory and production costs of future media advertising; these assets are expensed in the year first used.

Stock-Based Compensation. PepsiCo measures stock-based compensation cost as the excess of the quoted market price of PepsiCo's capital stock at the grant date over the amount the employee must pay for the stock. PepsiCo's policy is to generally grant stock options at fair market value at the date of grant; accordingly, no compensation cost is incurred.

Derivative Instruments. The interest differential to be paid or received on an interest rate swap is recognized as an adjustment to interest expense as the differential occurs. The interest differential not yet settled in cash is reflected in the Consolidated Balance Sheet as a receivable or payable under the appropriate current asset or liability caption. If an interest rate swap position was to be terminated, the gain or loss realized upon termination would be deferred and amortized to interest expense over the remaining term of the underlying debt instrument it was intended to modify or would be recognized immediately if the underlying debt instrument was settled prior to maturity.

The differential to be paid or received on a currency swap related to non-U.S. dollar denominated debt is charged or credited to income as the differential occurs. This is fully offset by the corresponding gain or loss recognized in income on the currency translation of the debt, as both amounts are based upon the same exchange rates. The currency differential not yet settled in cash is reflected in the Consolidated Balance Sheet under the appropriate current or noncurrent receivable or payable caption. If a currency swap position was to be terminated prior to maturity, the gain or loss realized upon termination would be immediately recognized in income.

Gains and losses on futures contracts designated as hedges of future commodity purchases are deferred and included in the cost of the related raw materials when purchased. Changes in the value of futures contracts used to hedge commodity purchases are highly correlated to the changes in the value of the purchased commodity. If the degree of correlation between the futures contracts and the purchased commodity were to ever significantly diminish during the contract term, subsequent changes in the value of the futures contracts would be recognized in income.

Cash Equivalents. Cash equivalents represent funds temporarily invested, with original maturities not exceeding three months, as part of PepsiCo's management of day-to-day operating cash receipts and disbursements. All other investment portfolios are primarily classified as short-term investments.

Inventories. Inventories are valued at the lower of cost (computed on the average, first-in, first-out or last-in, first-out method) or net realizable value.

Property, Plant and Equipment. Property, plant and equipment (PP&E) are stated at cost, except for PP&E that have been impaired, for which the carrying amount is reduced to estimated net realizable value. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets.

Intangible Assets. Intangible assets are amortized on a straight-line basis over appropriate periods, generally ranging from 20 to 40 years.

Recoverability of Long-Lived Assets to be Held and Used in the Business. All long-lived assets are evaluated for impairment in accordance with Statement of Financial Accounting Standards No. 121 (SFAS 121), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to B Disposed Of." Assets are generally grouped at the country level, by segment, for this purpose.

An impaired asset is written down to its estimated fair marke value based on the best information available; estimated fair ma. ket value is generally measured by discounting estimated future cash flows. Considerable management judgment is necessary to estimate discounted future cash flows. Accordingly, actual results could vary significantly from such estimates.

Note 2 – Unusual Items Affecting Comparability of Income from Continuing Operations

	1997	1996	1995
Dispose and write down assets	**$ 183**	$ 454	$ –
Improve productivity	**94**	122	–
Strengthen the international bottler structure	**13**	–	–
Initial adoption of SFAS 121	**–**	–	66
Net loss	**$ 290**	$ 576	$ 66
After-tax	**$ 239**	$ 527	$ 64
Per share	**$0.15**	$0.33	$0.04

The 1997 and 1996 unusual items include impairment charges of $200 million and $373 million, respectively (see Note 3). The 1997 net charge to strengthen the international bottler structure includes proceeds of $87 million associated with a settlement related to a previous Venezuelan bottler agreement, which were partially offset by related costs.

The 1995 initial, noncash charge reflects the early adoption of SFAS 121 (see Note 3).

Note 3 – Impairment of Long-Lived Assets

Impairment charges included in unusual items:

	1997	1996	1995
Held and Used in the Business			
Investments in unconsolidated affiliates	**$ –**	$ 190	$ –
Concentrate-related assets	**5**	116	–
Disposal of assets			
Investments in unconsolidated affiliates	**21**	20	–
Other businesses/assets	**174**	47	–
Initial adoption of SFAS 121	**–**	–	66
Total	**$ 200**	$ 373	$ 66
After-tax	**$ 169**	$ 356	$ 64
Per share	**$0.11**	$0.22	$0.04
By Segment			
Beverages	**$ 162**	$ 373	$ 62
Snack Foods	**38**	–	4
	$ 200	$ 373	$ 66

The charges associated with assets to be held and used in the business reflect a reduction in forecasted cash flows attributable to increased competitive activity and weakened macroeconomic factors in various geographic regions. The net charges for disposal of assets primarily reflect strategic decisions to realign the international bottling system, restructure certain Snack Foods operations and exit certain businesses. We anticipate the disposal of assets to be completed in 1998.

PepsiCo early adopted SFAS 121 as of the beginning of the fourth quarter of 1995. The initial, noncash charge resulted from PepsiCo grouping assets at a lower level than under its previous accounting policy for evaluating and measuring impairment.

Note 4 – Discontinued Operations

The Restaurants segment was composed of the core restaurant businesses of Pizza Hut, Taco Bell and KFC, PepsiCo Foods System (PFS), the restaurant distribution operation, and several non-core U.S. restaurant businesses. In 1997, PepsiCo announced its intention to spin off its restaurant businesses to its shareholders as an independent publicly traded company (Distribution) and sell PFS separately. The spin-off was effective as a tax-free Distribution on October 6, 1997 (Distribution Date). Owners of PepsiCo capital stock as of September 19, 1997 received one share of common stock of TRICON Global Restaurants, Inc. (TRICON), the new company, for every ten shares of PepsiCo capital stock. Just prior to the Distribution Date, PepsiCo received $4.5 billion in cash from TRICON as repayment of certain amounts due and a dividend. PFS and the non-core U.S. restaurant businesses were sold prior to the Distribution Date resulting in after-tax cash proceeds of approximately $1.0 billion.

Income from discontinued operations:

	1997	1996	1995
Net sales	**$ 8,375**	$ 11,441	$ 11,328
Costs and expenses	**(7,704)**	(10,935)	(10,946)
PFS gain	**500**	–	–
Interest expense, net	**(20)**	(25)	(40)
Provision for income taxes	**(500)**	(274)	(158)
Income from discontinued operations	**$ 651**	$ 207	$ 184

The above amounts include costs directly associated with the spin-off but do not include an allocation of PepsiCo interest or general and administrative expenses.

Note 5 – Income Per Share

PepsiCo adopted the provisions of Statement of Financial Accounting Standards No. 128, "Earnings Per Share," in 1997. Application of its provisions results in disclosure of two income per share measures, basic and assuming dilution, on the face of the Consolidated Statement of Income.

PepsiCo's reported net income represents its net income available to common stockholders for purposes of computing both measures. The following reconciles shares outstanding at the beginning of the year to average shares outstanding used to compute both income per share measures.

	1997	1996	1995
Shares outstanding at beginning of year	**1,545**	1,576	1,580
Weighted average shares issued during the year for exercise of stock options	**14**	13	9
Weighted average shares repurchased	**(31)**	(25)	(13)
Average shares outstanding – basic	**1,528**	1,564	1,576
Effect of dilutive securities			
Dilutive shares contingently issuable upon the exercise of stock options	**151**	169	151
Shares assumed to have been purchased for treasury with assumed proceeds from the exercise of stock options	**(109)**	(127)	(119)
Average shares outstanding – assuming dilution	**1,570**	1,606	1,608

Note 6 – Inventories

	1997	1996
Raw materials and supplies	**$400**	$484
Finished goods	**332**	369
	$732	$853

The cost of 43% of 1997 inventories and 39% of 1996 inventories was computed using the last-in, first-out method.

Note 7 – Property, Plant and Equipment, net

	1997	1996
Land	**$ 365**	$ 361
Buildings and improvements	**2,623**	2,543
Machinery and equipment	**7,513**	7,253
Construction in progress	**793**	751
	11,294	10,908
Accumulated depreciation	**(5,033)**	(4,822)
	$ 6,261	$ 6,086

Note 8 – Intangible Assets, net

	1997	1996
Reacquired franchise rights	**$2,780**	$2,917
Trademarks	**625**	650
Other identifiable intangibles	**152**	122
Goodwill	**2,298**	2,347
	$5,855	$6,036

Identifiable intangible assets primarily arise from the allocation of purchase prices of businesses acquired. Amounts assigned to such identifiable intangibles are based on independent appraisals or internal estimates. Goodwill represents the residual purchase price after allocation to all identifiable net assets.

The above amounts are net of accumulated amortization of $1.7 billion and $1.5 billion at year-end 1997 and 1996, respectively.

Note 9 – Accounts Payable and Other Current Liabilities

	1997	1996
Accounts payable	**$1,047**	$1,034
Accrued compensation and benefits	**640**	565
Accrued selling and marketing	**485**	542
Other current liabilities	**1,445**	1,237
	$3,617	$3,378

Note 10 – Long-term Debt

	1997	1996
Long-term Debt		
Commercial paper (5.4%)	**$ -**	$1,176
Notes due 1998-2011 (6.5% and 6.4%)	**2,643**	3,111
Various foreign currency debt, due 1998-2001 (5.2% and 5.5%)	**809**	1,448
Zero coupon notes, $1.0 billion due 1998-2012 (10.5% and 7.9%)	**480**	930
Euro notes due 1998-1999 (5.8% and 5.5%)	**500**	700
Other, due 1998-2020 (7.5% and 7.1%)	**514**	809
	$4,946	$8,174

The interest rates in the above table include the effects of associated interest rate and currency swaps at year-end 1997 and 1996. See Note 11 for a discussion of PepsiCo's use of interest rate and currency swaps, its management of the inherent credit risk and fair value information related to debt and interest rate and currency swaps.

The following table indicates the notional amount and weighted average interest rates, by category, of interest rate swaps outstanding at year-end 1997 and 1996, respectively. The weighted average variable interest rates that PepsiCo pays, which are primarily indexed to either commercial paper or LIBOR rates, are based on rates as of the respective balance sheet date and are subject to change. Terms of interest rate swaps match the terms of the debt they modify. The swaps terminate at various dates through 2011.

	1997	1996
Receive fixed-pay variable		
Notional amount	**$2,584**	$3,976
Weighted average receive rate	**6.8%**	6.6%
Weighted average pay rate	**5.8%**	5.5%
Receive variable-pay variable		
Notional amount	**$ 250**	$ 552
Weighted average receive rate	**5.7%**	5.5%
Weighted average pay rate	**5.8%**	5.7%
Receive variable-pay fixed		
Notional amount	**$ 215**	$ 215
Weighted average receive rate	**5.9%**	5.6%
Weighted average pay rate	**8.2%**	8.2%

At year-end 1997, approximately 77% of total debt was exposed to variable interest rates, compared to 74% in 1996. In addition to variable rate long-term debt, all debt with maturities of less than one year is categorized as variable for purposes of this measure.

PepsiCo enters into currency swaps to hedge its currency exposure on certain non-U.S. dollar denominated debt. At year-end 1997, the aggregate carrying amount of the debt was

$629 million and the payables under related currency swaps were $104 million, resulting in a net effective U.S. dollar liability of $733 million with a weighted average interest rate of 5.8%, including the effects of related interest rate swaps. At year-end 1996, the carrying amount of this debt aggregates $1.8 billion and the receivables and payables under related currency swaps aggregate $54 million and $59 million, respectively, resulting in a net effective U.S. dollar liability of $1.8 billion with a weighted average interest rate of 5.6%, including the effects of related interest rate swaps.

At year-end 1997 and 1996, PepsiCo's unused revolving credit facilities covering potential borrowings aggregate $2.75 billion and $3.5 billion, respectively. The 1997 facilities expire in 2002. These credit facilities exist largely to support the issuances of short-term borrowings and are available for general corporate purposes.

At year-end 1997 and 1996, $2.1 billion and $3.5 billion, respectively, of short-term borrowings were classified as long-term debt, reflecting PepsiCo's intent and ability, through the existence of the unused credit facilities, to refinance these borrowings.

The annual maturities of long-term debt through 2002 are: 1998-$2.1 billion, 1999-$939 million, 2000-$746 million, 2001-$353 million and 2002-$330 million.

Note 11 – Financial Instruments

Derivative Instruments

PepsiCo's policy prohibits the use of derivative instruments for trading purposes and PepsiCo has procedures in place to monitor and control their use.

PepsiCo's use of derivative instruments is primarily limited to interest rate and currency swaps, which are entered into with the objective of reducing borrowing costs. PepsiCo enters into interest rate and currency swaps to effectively change the interest rate and currency of specific debt issuances. These swaps are entered into concurrently with the issuance of the debt they are intended to modify. The notional amount, interest payment and maturity dates of the swaps match the principal, interest payment and maturity dates of the related debt. Accordingly, any market risk or opportunity associated with these swaps is offset by the opposite market impact on the related debt. PepsiCo's credit risk related to interest rate and currency swaps is considered low because they are entered into only with strong creditworthy counterparties, are generally settled on a net basis and are of relatively short duration. See Note 10 for the notional amounts, related interest rates and maturities of the interest rate and currency swaps. See Management's Discussion and Analysis – Market Risk beginning on page 13.

Fair Value

Carrying amounts and fair values of PepsiCo's financial instruments:

	1997		1996	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Assets				
Cash and cash equivalents	**$1,928**	**$1,928**	$ 307	$ 307
Short-term investments	**$ 955**	**$ 955**	$ 289	$ 289
Other assets (noncurrent investments)	**$ 15**	**$ 15**	$ 15	$ 15
Liabilities				
Debt				
Long-term debt	**$4,946**	**$5,161**	$8,174	$8,254
Debt-related derivative instruments				
Open contracts in asset position	**(28)**	**(22)**	(91)	(122)
Open contracts in liability position	**107**	**109**	62	74
Net debt	**$5,025**	**$5,248**	$8,145	$8,206

The carrying amounts in the above table are included in the Consolidated Balance Sheet under the indicated captions, except for debt-related derivative instruments (interest rate and currency swaps), which are included in the appropriate current or noncurrent asset or liability caption. Short-term investments consist primarily of debt securities and have been classified as held-to-maturity. Noncurrent investments mature at various dates through 2000.

Because of the short maturity of cash equivalents and short-term investments, the carrying amounts approximate fair value. The fair value of noncurrent investments is based upon market quotes. The fair value of debt and debt-related derivative instruments was estimated using market quotes and calculations based on market rates.

Note 12 – Income Taxes

Provision for income taxes on income from continuing operations:

		1997	1996	1995
Current:	Federal	**$598**	$254	$427
	Foreign	**110**	138	63
	State	**59**	72	60
		767	464	550
Deferred:	Federal	**23**	204	101
	Foreign	**15**	(41)	16
	State	**13**	(3)	2
		51	160	119
		$818	$624	$669

U.S. and foreign income from continuing operations before income taxes:

	1997	1996	1995
U.S.	**$1,731**	$1,630	$1,679
Foreign	**578**	(64)	412
	$2,309	$1,566	$2,091

Reconciliation of the U.S. Federal statutory tax rate to PepsiCo's effective tax rate on continuing operations:

	1997	1996	1995
U.S. Federal statutory tax rate	**35.0%**	35.0%	35.0%
State income tax, net of Federal tax benefit	**2.0**	2.9	2.0
Effect of lower taxes on foreign results	**(5.5)**	(4.4)	(4.8)
Settlement of prior years' audit issues	**(1.7)**	(2.9)	(4.8)
Effect of unusual items	**2.2**	9.7	1.0
Other, net	**3.4**	(0.5)	3.6
Effective tax rate on continuing operations	**35.4%**	39.8%	32.0%

Deferred tax liabilities are not recognized for basis differences related to investments in foreign subsidiaries and unconsolidated affiliates that are essentially permanent in duration. Determination of the amount of such unrecognized deferred tax liabilities is not practicable.

Deferred tax liabilities (assets):

	1997	1996
Intangible assets other than nondeductible goodwill	**$1,363**	$ 1,354
Property, plant and equipment	**500**	388
Safe harbor leases	**115**	143
Zero coupon notes	**84**	103
Other	**335**	172
Gross deferred tax liabilities	**2,397**	2,160
Net operating loss carryforwards	**(520)**	(406)
Postretirement benefits	**(247)**	(242)
Casualty claims	**(51)**	(36)
Various current liabilities and other	**(459)**	(350)
Gross deferred tax assets	**(1,277)**	(1,034)
Deferred tax assets valuation allowance	**458**	435
Net deferred tax assets	**(819)**	(599)
Net deferred tax liability	**$1,578**	$ 1,561
Included in		
Prepaid expenses, deferred income taxes and other current assets	**$ (119)**	$ (14)
Deferred income taxes	**1,697**	1,575
	$1,578	$ 1,561

Net operating loss carryforwards totaling $2.3 billion at year-end 1997 are available to reduce future taxable income of certain subsidiaries and are related to a number of foreign and state jurisdictions. Of these carryforwards, $56 million expire in 1998, $2.0 billion expire at various times between 1999 and 2011 and $215 million may be carried forward indefinitely.

Note 13 – Employee Stock Options

PepsiCo granted stock options to employees pursuant to three different incentive plans – the SharePower Stock Option Plan (SharePower), the Long-Term Incentive Plan (LTIP) and the Stock Option Incentive Plan (SOIP). SharePower stock options were granted to essentially all full-time employees. The number of options granted was based on each employee's annual earnings. The options generally became exercisable ratably over 5 years and had to be exercised within 10 years of the grant date.

Under the SOIP and LTIP, stock options were granted to middle and senior management employees, respectively. SOIP options were exercisable after 1 year and had to be exercised within 10 years of the grant date. Most LTIP options were exercisable after 4 years and had to be exercised within 10 years of the grant date. In addition, certain LTIP options could be exchanged by employees for a specified number of performance share units (PSUs) within 60 days of the grant date. The value of a PSU was fixed at the value of a share of stock at the grant date and vested 4 years from the grant date, contingent upon attainment of prescribed Corporate performance goals. At year-end 1997, 1996 and 1995, there were 801,000, 763,000 and 970,600 PSUs outstanding, respectively. Payment of PSUs are made in cash and/or stock as approved by the Compensation Committee of PepsiCo's Board of Directors. Amounts expensed in continuing operations for PSUs were $4 million in both 1997 and 1996 and $5 million in 1995. At year-end 1997, there were 41 million and 137 million shares available for grant under the SOIP and LTIP, respectively.

Stock option activity:

(Options in thousands)	1997		1996		1995	
	Options	**Weighted Average Exercise Price**	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of year	**177,217**	**$20.22**	160,662	$16.10	165,162	$14.60
Granted	**3,457**	**31.54**	51,305	31.19	26,390	22.70
Exercised	**(25,504)**	**15.77**	(22,687)	14.19	(21,181)	11.91
Surrendered for PSUs	**(15)**	**37.68**	(431)	29.91	(201)	20.67
Forfeited	**(7,819)**	**24.89**	(11,632)	23.13	(9,508)	17.69
Spin-off related						
Conversion to TRICON options (a)	**(13,267)**	**25.75**	–	–	–	–
PepsiCo modification (b)	**12,260**	–	–	–	–	–
Outstanding at end of year	**146,329**	**18.95**	177,217	20.22	160,662	16.10
Exercisable at end of year	**81,447**	**15.39**	80,482	14.92	65,474	12.63
Weighted average fair value of options granted during the year		**$10.55**		$ 8.89		$ 5.53

(a) Effective on the date of the TRICON spin-off, PepsiCo stock options held by TRICON employees were converted to TRICON stock options.

(b) Immediately following the spin-off, the number of options were increased and exercise prices were decreased (the "modification") to preserve the economic value of those options that existed just prior to the spin-off for the holders of PepsiCo stock options.

Stock options outstanding at December 27, 1997:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
\$ 4.25 to \$ 8.17	10,304	2.08 yrs.	\$ 6.18	9,739	\$ 6.20
\$ 8.20 to \$16.37	52,340	4.30	13.63	45,470	13.52
\$16.87 to \$37.72	83,685	7.28	23.85	26,238	22.04
	146,329	5.85	18.95	81,447	15.39

Pro forma income and pro forma income per share, as if the fair value-based method had been applied in measuring compensation cost for stock-based awards:

	1997	1996	1995
Reported			
Income			
Continuing operations	**\$1,491**	\$ 942	\$1,422
Discontinued operations	**651**	207	184
Net income	**\$2,142**	\$1,149	\$1,606
Income per share			
Continuing operations	**\$ 0.95**	\$ 0.59	\$ 0.88
Discontinued operations	**0.41**	0.13	0.12
Net income	**\$ 1.36**	\$ 0.72	\$ 1.00
Pro Forma			
Income			
Continuing operations	**\$1,390**	\$ 893	\$1,411
Discontinued operations	**635**	188	179
Net income	**\$2,025**	\$1,081	\$1,590
Income per share			
Continuing operations	**\$ 0.89**	\$ 0.55	\$ 0.88
Discontinued operations	**0.40**	0.12	0.11
Net income	**\$ 1.29**	\$ 0.67	\$ 0.99

Without the effect of pro forma costs related to the modification of outstanding options arising from the TRICON spin-off, pro forma income from continuing operations was \$1,436 million or \$0.92 per share in 1997.

The pro forma amounts disclosed above are not fully representative of the effects of stock-based awards because they exclude the pro forma cost related to the unvested stock options granted before 1995.

The fair values of the options granted (including the modification) were estimated using the Black-Scholes option-pricing model based on the following weighted average assumptions:

	1997	1996	1995
Risk free interest rate	**5.8%**	6.0%	6.2%
Expected life	**3 years**	6 years	5 years
Expected volatility	**20%**	20%	20%
Expected dividend yield	**1.32%**	1.5%	1.75%

Note 14 – Postretirement Benefits Other Than Pensions

PepsiCo provides postretirement health care benefits to eligible retired employees and their dependents, principally in the U.S. Retirees who have 10 years of service and attain age 55 while in service with PepsiCo are eligible to participate in the postretirement benefit plans. The plans are not funded and include some retiree cost sharing beginning in 1993.

Postretirement benefit expense for 1997, 1996 and 1995 was \$34 million, \$39 million and \$36 million, respectively.

Postretirement benefit liability recognized in the Consolidated Balance Sheet:

	1997	1996
Actuarial present value of postretirement benefit obligation		
Retirees	**\$255**	\$275
Fully eligible active plan participants	**100**	96
Other active plan participants	**173**	154
Accumulated postretirement benefit obligation	**528**	525
Unrecognized gains	**116**	122
	\$644	\$647

The discount rate assumptions used to compute the accumulated postretirement benefit obligation were 7.4% and 7.8% in 1997 and 1996, respectively.

Separate assumed health care cost trend rates are used for employees who retire before and after retiree cost sharing was introduced. The assumed health care cost trend rate for employees who retired before cost sharing was 7.4% for 1998, declining gradually to 5.5% in 2005 and thereafter. For employees retiring after the introduction of cost sharing, the trend rate was 6.5% for 1998, declining to zero in 2004 and thereafter.

Note 15 – Pension Plans

PepsiCo sponsors noncontributory defined benefit pension plans covering substantially all full-time U.S. employees as well as contributory and noncontributory defined benefit pension plans covering certain international employees. Benefits generally are based on years of service and compensation or stated amounts for each year of service. PepsiCo funds the U.S. plans in amounts not less than minimum statutory funding requirements nor more than the maximum amount that can be deducted for U.S. income tax purposes. International plans are funded in amounts sufficient to comply with local statutory requirements. The plans' assets consist principally of equity securities, government and corporate debt securities and other fixed-income obligations. The U.S. plans' assets included 11.7 million and 12.2 million shares of PepsiCo capital stock in 1997 and 1996, with a post-spin adjusted market value of $436 million and $316 million, respectively. In the interest of maintaining an appropriate level of diversification within the U.S. plans' asset portfolio, .5 million and 1.5 million shares of PepsiCo capital stock were sold during the 1997 and 1996 plan years, respectively. Dividends on PepsiCo capital stock of $6 million and $5 million were received by the U.S. plans in 1997 and 1996, respectively.

Components of net pension expense for company-sponsored plans:

	U.S. Plans			International Plans		
	1997	1996	1995	**1997**	1996	1995
Service cost of benefits earned	**$ 69**	$ 62	$ 46	**$ 13**	$ 12	$ 10
Interest cost on projected benefit obligation	**103**	93	78	**20**	18	16
Return on plan assets						
Actual gain	**(370)**	(163)	(287)	**(57)**	(38)	(30)
Deferred gain	**253**	55	188	**26**	10	6
	(117)	(108)	(99)	**(31)**	(28)	(24)
Amortization of net transition gain	**(14)**	(14)	(14)	**–**	–	–
Net other amortization	**13**	11	4	**3**	1	–
	$ 54	$ 44	$ 15	**$ 5**	$ 3	$ 2

Reconciliations of the funded status of the plans to the pension liability:

	U.S. Plans				International Plans			
	Assets Exceed Accumulated Benefits		Accumulated Benefits Exceed Assets		Assets Exceed Accumulated Benefits		Accumulated Benefits Exceed Assets	
	1997	1996	**1997**	1996	**1997**	1996	**1997**	1996
Actuarial present value of benefit obligation								
Vested benefits	**$ (1,177)**	$(1,036)	**$ (57)**	$ (34)	**$(223)**	$(173)	**$(21)**	$(30)
Nonvested benefits	**(153)**	(133)	**(3)**	(2)	**(7)**	(5)	**(2)**	(4)
Accumulated benefit obligation	**(1,330)**	(1,169)	**(60)**	(36)	**(230)**	(178)	**(23)**	(34)
Effect of projected compensation increases	**(165)**	(143)	**(69)**	(67)	**(42)**	(33)	**(9)**	(12)
Projected benefit obligation	**(1,495)**	(1,312)	**(129)**	(103)	**(272)**	(211)	**(32)**	(46)
Plan assets at fair value	**1,655**	1,337	**–**	2	**328**	282	**14**	17
Plan assets in excess of (less than) projected benefit obligation	**160**	25	**(129)**	(101)	**56**	71	**(18)**	(29)
Unrecognized prior service cost	**63**	65	**17**	20	**3**	3	**–**	–
Unrecognized net (gain)/loss	**(205)**	(26)	**39**	28	**42**	25	**2**	5
Unrecognized net transition (gain)/loss	**(15)**	(29)	**–**	–	**(1)**	(1)	**–**	3
Prepaid (accrued) pension liability	**$ 3**	$ 35	**$ (73)**	$ (53)	**$ 100**	$ 98	**$(16)**	$(21)

Assumptions used to compute the information presented above:

	U.S. Plans			International Plans		
	1997	1996	1995	**1997**	1996	1995
Expected long-term rate of return on plan assets	**10.0%**	10.0	10.0	**11.5%**	11.4	11.3
Discount rate – projected benefit obligation	**7.2%**	7.7	7.7	**7.6%**	8.4	8.8
Future compensation growth rate	**3.2%-6.5%**	3.2-6.6	3.3-6.6	**3.0%-13.8%**	3.0-10.5	3.0-11.8

The discount rates and rates of return for the international plans represent weighted averages.

Note 16 – Contingencies

PepsiCo is subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. Management believes that the ultimate liability, if any, in excess of amounts already recognized arising from such claims or contingencies is not likely to have a material adverse effect on PepsiCo's annual results of operations or financial condition.

Note 17 – Business Segments

PepsiCo operates on a worldwide basis within two industry segments: beverages and snack foods.

Beverages

The beverage segment (Beverages) markets and distributes its Pepsi-Cola, Diet Pepsi, Mountain Dew and other brands worldwide, and 7UP, Diet 7UP, Mirinda, Pepsi Max and other brands internationally. Beverages manufactures concentrates of its brands for sale to franchised bottlers worldwide. Beverages operates bottling plants and distribution facilities located in North America and in various international markets for the production and distribution of company-owned and licensed brands. Beverages also manufactures and distributes ready-to-drink Lipton tea products in North America.

Principal international markets include Argentina, Brazil, China, India, Mexico, the Philippines, Saudi Arabia, Spain, Thailand and the U.K. Investments in unconsolidated affiliates of $340 million in the U.S. and $605 million outside the U.S. at year-end 1997 are primarily in franchised bottling and distribution operations. The primary investment in the U.S. is General Bottlers. Internationally, the largest investments in unconsolidated affiliates are Grupo Embotellador de Mexico, S.A. (Mexico), General Bottlers (Poland), Serm Suk (Thailand) and Sociedad Productora de Refrescos y Sabores, SOPRESA, C.A. (Venezuela) as well as the aggregate of several investments in China.

Snack Foods

The snack food segment (Snack Foods) manufactures, distributes and markets salty and sweet snacks worldwide, with Frito-Lay representing the North American business. Products primarily manufactured and distributed in North America include Lay's and Ruffles brand potato chips, Doritos and Tostitos brand tortilla chips, Fritos brand corn chips, Chee·tos brand cheese flavored snacks, Rold Gold brand pretzels, a variety of dips and salsas and other brands. Low-fat and no-fat versions of several core brands are also manufactured and distributed in North America.

Principal international salty snack markets include Brazil, Mexico, the Netherlands, South Africa, Spain and the U.K. In addition, International Snack Foods manufactures and distributes sweet snacks in certain countries, primarily in France, Mexico and Poland. Snack Foods has $234 million of investments in several unconsolidated affiliates outside the U.S. at year-end 1997. The largest investments are Snack Ventures Europe, a joint venture with General Mills, Inc., which has operations on the continent of Europe, and an investment in Simba, with operations in South Africa.

Unallocated expenses, net includes corporate headquarters expenses, minority interests and foreign exchange translation and transaction gains and losses. Corporate identifiable assets consist principally of cash and cash equivalents and short-term investments.

Unusual Items Affecting Comparability

	1997	1996	1995
Beverages	$206	$320	$62
Snack Foods	106	–	4
Combined Segments	312	320	66
Equity (Income)/Loss	(22)	256	–
	$290	$576	$66

The 1997 and 1996 unusual items relate to decisions to dispose of and write down assets, improve productivity and strengthen the international bottler structure (see Note 2). Equity (Income)/Loss in 1996 includes charges primarily related to the write down of our investment in Buenos Aires Embotelladora S.A. (BAESA) and our share of the unusual charges recorded by BAESA. The 1995 unusual item reflects the initial, noncash charge upon adoption of SFAS 121.

INDUSTRY SEGMENTS

	1997	1996	1995
NET SALES			
Beverages	$10,541	$10,587	$10,467
Snack Foods	10,376	9,750	8,600
	$20,917	$20,337	$19,067

	1997	1996	1995
OPERATING PROFIT (a)			
Beverages	$ 1,114	$ 890	$ 1,309
Snack Foods	1,695	1,608	1,432
Combined Segments	2,809	2,498	2,741
Equity Income/(Loss)	84	(274)	38
Unallocated Expenses, net	(231)	(184)	(173)
	$ 2,662	$ 2,040	$ 2,606

	1997	1996	1995
Amortization of Intangible Assets			
Beverages	$ 155	$ 165	$ 167
Snack Foods	44	41	41
	$ 199	$ 206	$ 208

	1997	1996	1995
Depreciation Expense			
Beverages	$ 444	$ 440	$ 445
Snack Foods	394	346	304
Corporate	7	7	7
	$ 845	$ 793	$ 756

	1997	1996	1995
Identifiable Assets			
Beverages	$ 9,752	$ 9,816	$10,032
Snack Foods	6,998	6,279	5,451
Investments in Unconsolidated Affiliates	1,201	1,147	1,253
Corporate	2,150	468	1,464
Net Assets of Discontinued Operations	–	4,450	4,744
	$20,101	$22,160	$22,944

	1997	1996	1995
Capital Spending			
Beverages	$ 618	$ 648	$ 563
Snack Foods	873	973	768
Corporate	15	9	34
	$ 1,506	$ 1,630	$ 1,365
United States	$ 996	$ 1,109	$ 928
International	510	521	437
	$ 1,506	$ 1,630	$ 1,365

	1997	1996	1995
Acquisitions and Investments in Unconsolidated Affiliates			
Beverages	$ 43	$ 75	$ 318
Snack Foods	76	–	82
	$ 119	$ 75	$ 400
United States	$ 3	$ 15	$ 37
International	116	60	363
	$ 119	$ 75	$ 400

GEOGRAPHIC AREAS (b)

	Net Sales			Segment Operating Profit (Loss) (c)			Identifiable Assets		
	1997	1996	1995	1997	1996	1995	1997	1996	1995
Europe	$ 2,327	$ 2,513	$ 2,451	$ (133)	$ (88)	$ (7)	$ 1,130	$ 1,224	$ 1,382
Canada	941	946	889	105	116	94	1,013	1,045	1,054
Mexico	1,541	1,314	1,204	214	105	135	685	583	550
United Kingdom	859	810	751	106	159	139	1,582	1,542	1,408
Other	1,371	1,346	1,371	(50)	(342)	103	1,670	1,698	1,672
Total International	7,039	6,929	6,666	242	(50)	464	6,080	6,092	6,066
United States	13,878	13,408	12,401	2,567	2,548	2,277	10,670	10,003	9,417
Combined Segments	$20,917	$20,337	$19,067	$ 2,809	$ 2,498	$ 2,741	16,750	16,095	15,483
Investments in Unconsolidated Affiliates							1,201	1,147	1,253
Corporate							2,150	468	1,464
Net Assets of Discontinued Operations							–	4,450	4,744
							$20,101	$22,160	$22,944

(a) See Unusual Items Affecting Comparability on page 32.

(b) The results of centralized concentrate manufacturing operations in Puerto Rico and Ireland have been allocated based upon sales to the respective geographic areas.

(c) The unusual items reduce combined segment operating profit by $290 (United States – $74, Europe – $96, Mexico – $(17), United Kingdom – $53, Other – $84) in 1997, $576 (Europe – $69, Mexico – $4, Other – $503) in 1996 and $66 (Europe – $62, Other – $4) in 1995 (see Unusual Items Affecting Comparability on page 32).

Note 18 – Selected Quarterly Financial Data

($ in millions except per share amounts, unaudited)

	First Quarter (12 Weeks)		Second Quarter (12 Weeks)		Third Quarter (12 Weeks)		Fourth Quarter (16 Weeks)		Full Year (52 Weeks)	
	1997	1996	**1997**	1996	**1997**	1996	**1997**	1996	**1997**	1996
Net sales	**$ 4,213**	4,053	**$5,086**	5,075	**$ 5,362**	5,159	**$ 6,256**	6,050	**$20,917**	20,337
Gross profit	**$ 2,492**	2,387	**$3,017**	2,963	**$ 3,183**	3,001	**$ 3,700**	3,534	**$12,392**	11,885
Unusual items – (gain)/loss [(a)]	**$ (22)**	–	**$ 326**	–	**$ –**	390	**$ (14)**	186	**$ 290**	576
Operating profit	**$ 581**	532	**$ 436**	774	**$ 929**	333	**$ 716**	401	**$ 2,662**	2,040
Income from continuing operations	**$ 318**	296	**$ 176**	438	**$ 551**	10	**$ 446**	198	**$ 1,491**	942
Income from discontinued operations [(b)]	**$ 109**	98	**$ 480**	145	**$ 107**	134	**$ (45)**	(170)	**$ 651**	207
Net income	**$ 427**	394	**$ 656**	583	**$ 658**	144	**$ 401**	28	**$ 2,142**	1,149
Net income per share – basic										
Continuing operations	**$ 0.21**	0.19	**$ 0.11**	0.27	**$ 0.36**	0.01	**$ 0.30**	0.13	**$ 0.98**	0.60
Discontinued operations	**$ 0.07**	0.06	**$ 0.31**	0.10	**$ 0.07**	0.08	**$ (0.03)**	(0.11)	**$ 0.42**	0.13
Net income	**$ 0.28**	0.25	**$ 0.42**	0.37	**$ 0.43**	0.09	**$ 0.27**	0.02	**$ 1.40**	0.73
Net income per share – assuming dilution										
Continuing operations	**$ 0.20**	0.18	**$ 0.11**	0.27	**$ 0.35**	0.01	**$ 0.29**	0.13	**$ 0.95**	0.59
Discontinued operations	**$ 0.07**	0.06	**$ 0.31**	0.09	**$ 0.07**	0.08	**$ (0.04)**	(0.10)	**$ 0.41**	0.13
Net income	**$ 0.27**	0.24	**$ 0.42**	0.36	**$ 0.42**	0.09	**$ 0.25**	0.03	**$ 1.36**	0.72
Cash dividends declared per share	**$ 0.115**	0.10	**$0.125**	0.115	**$ 0.125**	0.115	**$ 0.125**	0.115	**$ 0.49**	0.445
Stock price per share [(c)]										
High	**$34 55/64**	33 3/8	**$ 39**	34 1/2	**$39 11/16**	35 5/8	**$ 40**	32 7/8	**$ 40**	35 5/8
Low	**$ 29 1/8**	27 1/2	**$31 1/4**	29 11/16	**$ 35 1/2**	28 1/4	**$ 34 1/4**	28 1/8	**$ 29 1/8**	27 1/2
Close	**$ 32 1/2**	31 5/8	**$ 39**	33 1/8	**$ 37 5/8**	28 3/8	**$34 11/16**	29 5/8	**$34 11/16**	29 5/8

Notes:

(a) Unusual items – (gain)/loss (see Note 2):

	1997			1996		
	Pre-Tax	After-Tax	Per Share	Pre-Tax	After-Tax	Per Share
First quarter	$ (22)	$ 2	$ –	$ –	$ –	$ –
Second quarter	326	238	0.15	–	–	–
Third quarter	–	–	–	390	376	0.23
Fourth quarter	(14)	(1)	–	186	151	0.10
Full year	$290	$239	$0.15	$576	$527	$0.33

(b) See Note 4.

(c) Represents the high, low and closing prices for one share of PepsiCo capital stock on the New York Stock Exchange (NYSE). Stock prices on or before October 6, 1997 are not adjusted to reflect the TRICON spin-off (see Note 4).

Management's Responsibility for Financial Statements

To Our Shareholders:

Management is responsible for the reliability of the consolidated financial statements and related notes, which have been prepared in conformity with generally accepted accounting principles and include amounts based upon our estimates and assumptions, as required. The financial statements have been audited and reported on by our independent auditors, KPMG Peat Marwick LLP, who were given free access to all financial records and related data, including minutes of the meetings of the Board of Directors and Committees of the Board. We believe that management representations made to the independent auditors were valid and appropriate.

PepsiCo maintains a system of internal control over financial reporting, designed to provide reasonable assurance as to the reliability of the financial statements, as well as to safeguard assets from unauthorized use or disposition. The system is supported by formal policies and procedures, including an active Code of Conduct program intended to ensure employees adhere to the highest standards of personal and professional integrity. PepsiCo's internal audit function monitors and reports on the adequacy of and compliance with the internal control system, and appropriate actions are taken to address significant control deficiencies and other opportunities for improving the system as they are identified. The Audit Committee of the Board of Directors, which is composed solely of outside directors, provides oversight to our financial reporting process and our controls to safeguard assets through periodic meetings with our independent auditors, internal auditors and management. Both our independent auditors and internal auditors have free access to the Audit Committee.

Although no cost-effective internal control system will preclude all errors and irregularities, we believe our controls as of December 27, 1997 provide reasonable assurance that the financial statements are reliable and that our assets are reasonably safeguarded.

Report of Independent Auditors

Board of Directors and Shareholders
PepsiCo, Inc.

We have audited the accompanying consolidated balance sheet of PepsiCo, Inc. and Subsidiaries as of December 27, 1997 and December 28, 1996 and the related consolidated statements of income, cash flows and shareholders' equity for each of the years in the three-year period ended December 27, 1997. These consolidated financial statements are the responsibility of PepsiCo, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PepsiCo, Inc. and Subsidiaries as of December 27, 1997 and December 28, 1996, and the results of their operations and their cash flows for each of the years in the three-year period ended December 27, 1997, in conformity with generally accepted accounting principles.

As discussed in Note 3 to the consolidated financial statements, PepsiCo, Inc. in 1995 adopted the provisions of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of."

KPMG Peat Marwick LLP

KPMG Peat Marwick LLP
New York, New York
February 3, 1998

Selected Financial Data

(in millions except per share and employee amounts, unaudited)
PepsiCo, Inc. and Subsidiaries

	1997[a]	1996[a]	1995[b]	1994[c][d][e]	1993
Summary of Operations					
Net sales	**$ 20,917**	20,337	19,067	17,984	15,706
Operating profit	**$ 2,662**	2,040	2,606	2,506	2,141
Income from continuing operations	**$ 1,491**	942	1,422	1,363	1,152
Cash Flow Data					
Dividends paid	**$ 736**	675	599	540	462
EBITDA from continuing operations [f]	**$ 4,001**	3,479	3,718	NA	NA
Free cash flow from continuing operations [g]	**$ 1,382**	725	556	NA	NA
Share repurchases	**$ 2,459**	1,651	541	549	463
Per Share Data					
Income from continuing operations – assuming dilution	**$ 0.95**	0.59	0.88	0.85	0.71
Cash dividends declared	**$ 0.49**	0.445	0.39	0.35	0.305
Book value per share at year-end	**$ 4.62**	4.29	4.64	4.34	3.97
Market price per share at year-end [h]	**$ 34 11/16**	29 5/8	27 15/16	18 1/8	20 15/16
Market price per share at year-end – continuing operations [i]	**$ 34 11/16**	27 15/64	25 43/64	16 21/32	19 1/4
Balance Sheet					
Net assets of discontinued operations [j]	**$ –**	4,450	4,744	5,183	4,548
Total assets [k]	**$ 20,101**	22,160	22,944	22,533	21,628
Long-term debt	**$ 4,946**	8,174	8,248	8,570	7,148
Total debt [l]	**$ 4,946**	8,174	8,806	9,114	9,209
Shareholders' equity	**$ 6,936**	6,623	7,313	6,856	6,339
Other Statistics					
Number of shares repurchased	**69.0**	54.2	24.6	30.0	24.8
Shares outstanding at year-end	**1,502**	1,545	1,576	1,580	1,598
Average shares outstanding used to calculate income per share from continuing operations – assuming dilution	**1,570**	1,606	1,608	1,608	1,620
Employees of continuing operations	**142,000**	137,000	137,000	129,000	119,000

NA – Not available

PepsiCo disposed of its Restaurants segment in 1997 and accounted for it as discontinued operations (see Note 4); all information has been reclassified accordingly. Additionally, PepsiCo made numerous acquisitions in most years presented and a few divestitures in certain years. Such transactions do not materially affect the comparability of PepsiCo's operating results for the periods presented. All share and per share amounts reflect a two-for-one stock split in 1996 and per share amounts are computed using average shares outstanding, assuming dilution.

(a) Includes unusual items of $290 ($239 after-tax or $0.15 per share) in 1997 and $576 ($527 after-tax or $0.33 per share) in 1996. See Note 2.

(b) Includes the initial, noncash charge of $66 ($64 after-tax or $0.04 per share) upon adoption of SFAS 121 at the beginning of the fourth quarter.

(c) Includes the cumulative effect of adopting SFAS 112 "Employers' Accounting for Postemployment Benefits" of $77 ($51 after-tax or $0.03 per share) and changing to a preferable method for calculating the market-related value of plan assets used in determining the return-on-asset component of annual pension expense and the cumulative net unrecognized gain or loss subject to amortization of $32 ($20 after-tax or $0.01 per share). Prior years were not restated for these changes in accounting.

(d) Includes a benefit of changing to the preferable method for calculating the market value of plan assets in 1994, which reduced full year pension expense by $29 ($18 after-tax or $0.01 per share).

(e) Fiscal year 1994 consists of 53 weeks. Normally, fiscal years consist of 52 weeks; however, because the fiscal year ends on the last Saturday in December, a week is added every 5 or 6 years. The fifty-third week increased 1994 earnings by approximately $31 ($28 after-tax or $0.02 per share).

(f) Defined as earnings before interest, taxes, depreciation and amortization which is presented net of the noncash portion of unusual items of $233 in 1997, $366 in 1996 and $66 in 1995. EBITDA is used by certain investors as a measure of a company's ability to service its debt. It should be considered in addition to, but not as a substitute for, other measures of financial performance in accordance with generally accepted accounting principles (GAAP).

(g) Defined as net cash provided by operating activities reduced by cash dividends paid and adjusted for the following investing activities: capital spending, sales of businesses, sales of property, plant and equipment and other, net. Free cash flow is a measure we use internally to evaluate our cash flow performance and should be considered in addition to, but not as a substitute for, other measures of financial performance in accordance with GAAP.

(h) Represents historically reported market price of one share of PepsiCo, Inc. capital stock.

(i) Represents approximately 92% of the historical market price of one share of PepsiCo, Inc. capital stock, which is the allocated market value of PepsiCo's packaged goods businesses used by the NYSE on or before October 6, 1997. The remaining 8% represents the market value allocated to TRICON Global Restaurants, Inc.

(j) Represents net assets of discontinued operations (see Note 4), which are included in total assets.

(k) Includes net assets of discontinued operations.

(l) Includes short-term borrowings and long-term debt.

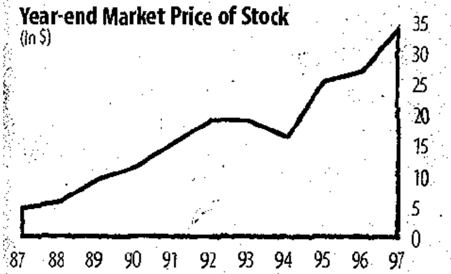
Stock Performance

PepsiCo was formed through the 1965 merger of Pepsi-Cola Company and Frito-Lay, Inc. A $1,000 investment in our stock made on December 31, 1987 was worth approximately $8,300 on December 31, 1997 assuming the reinvestment of dividends. This performance represents a compounded annual growth rate of 24%.

The closing price for a share of PepsiCo capital stock on the New York Stock Exchange was the price as reported by Bloomberg for the fiscal years ending 1987-1997, restated for the spin-off of the restaurant business.

Past performance is not necessarily indicative of future returns on investments in PepsiCo capital stock.

Year-end Market Price of Stock
(In $)



Capital Stock Information

Stock Trading Symbol

PEP

Stock Exchange Listings

The New York Stock Exchange is the principal market for PepsiCo capital stock, which is also listed on the Amsterdam, Chicago, Swiss and Tokyo Stock Exchanges.

Shareholders

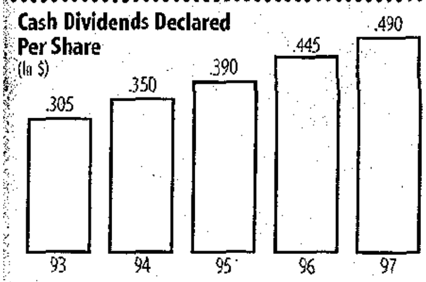
At year-end 1997, there were approximately 229,000 shareholders of record.

Dividend Policy

Quarterly cash dividends are usually declared in November, January, May and July and paid at the beginning of January and the end of March, June and September. The dividend record dates for 1998 are expected to be March 13, June 12, September 11 and December 11.

Quarterly cash dividends have been paid since PepsiCo was formed in 1965, and dividends per share have increased for 25 consecutive years.

Cash Dividends Declared Per Share
(In $)



Shareholder Information

Annual Meeting

The Annual Meeting of Shareholders will be held at Frito-Lay Corporate Headquarters on 7701 Legacy Drive, Plano, Texas at 1:00 p.m. local time, Wednesday, May 6, 1998. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

Inquiries Regarding Your Stock Holdings

Registered Shareholders (shares held by you in your name) should address communications concerning statements, dividend payments, address changes, lost certificates and other administrative matters to:

PepsiCo, Inc. c/o BankBoston, N.A. P.O. Box 9155 Boston, MA 02205-9155 Telephone: (800)226-0083	or	Manager, Shareholder Relations PepsiCo, Inc. Purchase, NY 10577 Telephone: (914)253-3055

In all correspondence or telephone inquiries, please mention PepsiCo, your name as printed on your stock certificate, your Social Security number, your address and telephone number.

Beneficial Shareholders (shares held in the name of your bank or broker) should direct communications on all administrative matters to your stockbroker.

SharePower Participants (employees with SharePower options) should address all questions regarding your account, outstanding options or shares received through option exercises to:

Merrill Lynch/SharePower
Stock Option Plan Services
P.O. Box 30466
New Brunswick, NJ 08989-0446
Telephone: (800)637-6713 (U.S., Puerto Rico and Canada)
(732)469-8877 (all other locations)

In all correspondence, please provide your account number (for U.S. citizens, this is your Social Security number), your address, your telephone number and mention PepsiCo SharePower. For telephone inquiries, please have a copy of your most recent statement available.

Employee Benefit Plan Participants

Capital Stock Purchase Plan	(800)227-4015
SaveUp (formerly 401(k) or Long Term Savings)	(800)227-4015
P.O. Box 9108	(617)472-3127
Boston, MA 02209	(outside U.S.)
ESOP	(800)227-4015

Please have a copy of your most recent statement available when calling. Press *0 for a customer service representative and give the representative the name of the Plan.

Shareholder Services

Dividend Reinvestment Plan

A brochure explaining this convenient plan, for which PepsiCo pays all administrative costs, is available from our transfer agent:

PepsiCo, Inc.
c/o BankBoston, N.A.
P.O. Box 9156
Boston, MA 02205-9156 Telephone: (800)226-0083

Direct Deposit of Dividends

Information on the Direct Deposit service is available from our transfer agent at this address:

PepsiCo, Inc.
c/o BankBoston, N.A.
P.O. Box 9155
Boston, MA 02205-9155 Telephone: (800)226-0083

Low-Cost Investment Plan

Investors may purchase their initial five shares of stock through NAIC's Low-Cost Investment Plan. For details contact:

National Association of Investors Corporation (NAIC)
711 West Thirteen Mile Road
Madison Heights, MI 48071
Telephone: (248)583-NAIC (6242)

Financial and Other Information

PepsiCo's 1998 quarterly earnings releases are expected to be issued the week of April 27, July 20, and October 12, 1998 and February 1, 1999.

Earnings and other financial results, corporate news, information on the spin-off of the restaurant businesses and other company information are available on PepsiCo's web site: **http://www.pepsico.com**

Copies of PepsiCo's SEC Form 8-K, 10-K and 10-Q reports and quarterly earnings releases are available free of charge. Contact PepsiCo's Manager of Shareholder Relations at (914)253-3055.

Securities analysts, portfolio managers, representatives of financial institutions and other individuals with questions regarding PepsiCo's performance are invited to contact:

Margaret D. Moore
Vice President, Investor Relations
PepsiCo, Inc.
Purchase, NY 10577 Telephone: (914)253-3035

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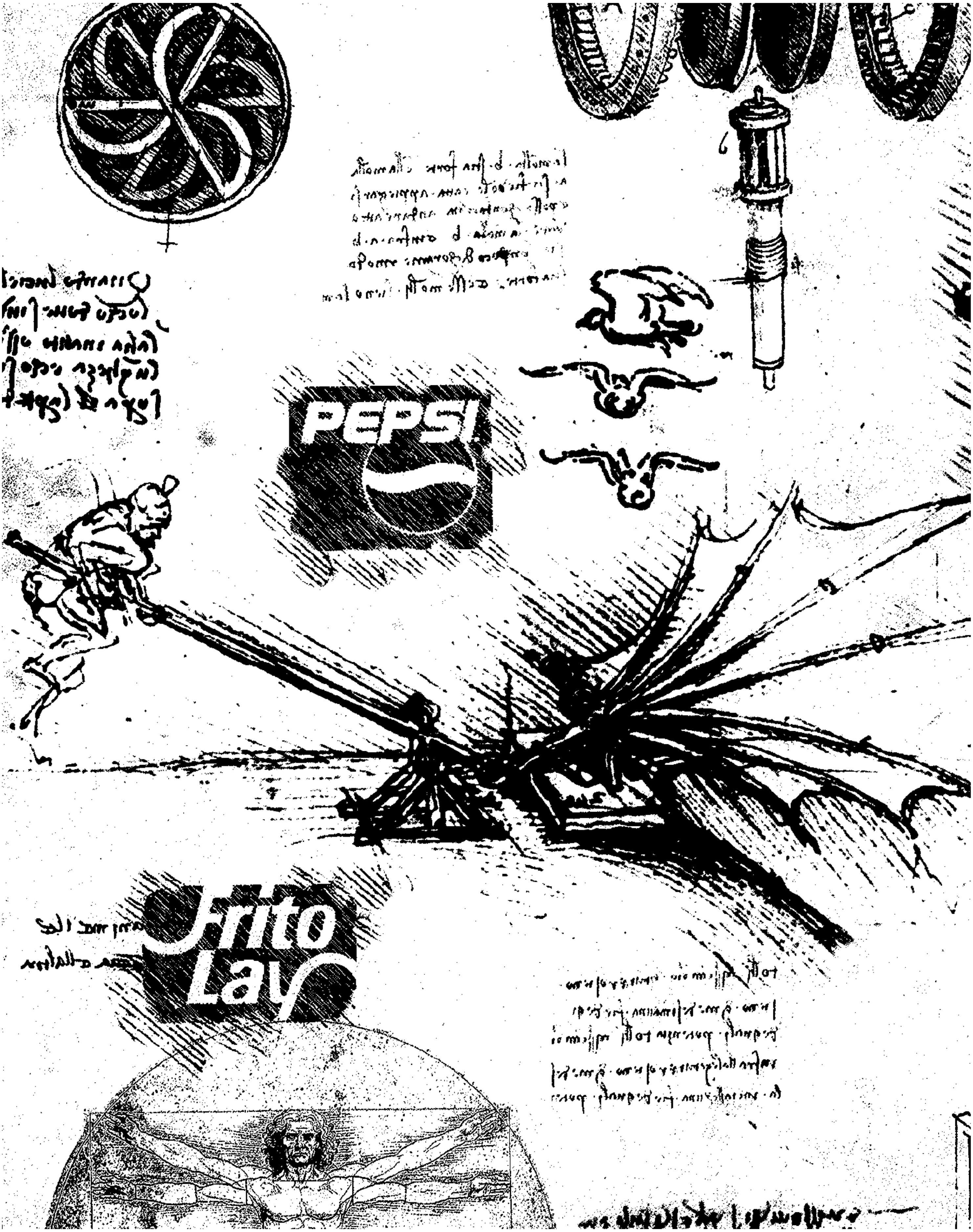
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